

**CULVERHOUSE SCHOOL OF ACCOUNTANCY**  
**AC523 – Business Valuation and Performance Measurement**  
**Mondays and Wednesdays**  
**09:30 a.m. and 11:00 a.m. sections**  
**Fall 2009**

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Office Hours: Tuesdays and Thursdays 11:00–2:00 a.m. and by appointment

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**COURSE DESCRIPTION:**

This course deals with the analysis of financial information - particularly firms' financial statements - for making decisions to invest in businesses. The primary focus will be on equity (stock) valuation, with some attention given to credit analysis and the valuation of debt. Methods to determine stock value using fundamental analysis will be examined in detail and applied in projects involving listed companies. Topics include a comparison of accounting and discounted cash flow approaches to valuation, methods of financial statement analysis, dealing with accounting issues, forecasting firms' futures, determining firms' price/earnings and market-to-book ratios, and the analysis of risk.

The focus of the course is on valuation of securities using accounting information. Particular emphasis is given to the residual income valuation model. This model has become very popular in major MBA programs in the US and it is also being used by many large U.S. investors. The appeal of the model is that valuation is based on accounting data (that is, data prepared under GAAP) -- these data are not only available ex post but they are also commonly available ex ante as forecasts.

The residual income model of performance evaluation has been taught in management accounting courses for decades. During the 1990s this model became extremely popular in divisional and manager performance evaluation and it has become more generally known as EVA (following the trade-marked version marketed by Stern-Stewart). The residual income model will be illustrated using security valuation (rather than valuation of divisions, products, etc.) because the examples are not confused by the added complication of identifying book value of the investment and income at the division, department, or manager level but once this is done, the model can be applied to value these parts of the firm. This method then has the added advantage that at the end of each production period, income and book value are usually readily available from accounting statements prepared during the period. Companies have used such data for ex post performance evaluation for decades but different (generally cash flow) data have been used for ex ante decision-making. Now we have a method which permits use of the same data for ex ante decision-making and for ex post performance evaluation.

## **COURSE OBJECTIVES:**

By the end of the course students should have answers to the following questions:

- How are "intrinsic values" calculated?
- What are the relevant firm attributes that determine value?
- What is the role of financial statements in determining intrinsic values?
- Are some aspects of the financial statements more important than others? What is the role of "bottom line" earnings (net income) and book value?
- How does one pull apart the financial statements to get at the relevant information?
- What is the relevance of cash-flow information? What is the relevance of the accruals in accounting?
- How does traditional ratio analysis help in valuation?
- How does one deal with the accounting methods used in financial statements?
- What is profitability? What is growth? How do they tie into valuation?
- What determines a firm's P/E ratio? What determines a firm's market-to-book (P/B) ratio? How do they articulate?
- How does one evaluate risk? For equity? For debt?

## **REQUIRED MATERIALS:**

Financial Statement Analysis and Security Valuation, 4th Edition, by Stephen H. Penman (McGraw-Hill Irwin, 2009).

Additional materials may be made available via the web site and/or distributed in class.

## **OTHER REFERENCE MATERIALS:**

The following books provide useful reference for the course:

- A good introduction is:
  - Valuation: Measuring and Managing the Value of Companies, 4<sup>th</sup> Edition, by Copeland, Koller, Goedhart, Wessels and Lessard (Wiley, 2005)
- Other books on financial statement analysis:
  - Financial Reporting and Statement Analysis: A Strategic Perspective, 6<sup>th</sup> Edition, by Stickney, Brown and Wahlen (South-Western, 2006)
  - Analysis and Use of Financial Statements, 3<sup>rd</sup> Edition, by White, Sondhi and Fried (Wiley, 2003)
  - Business Analysis and Valuation: Using Financial Statements: Text and Cases, 3<sup>rd</sup> Edition, by Palepu, Bernard and Healy (South-Western, 2003)
  - Financial Reporting and Analysis, 3<sup>rd</sup> Edition, by Revsine, Collins and Johnson (Prentice Hall, 2004)
- A text on US GAAP:
  - Financial Accounting for MBAs, 2<sup>nd</sup> Edition, by Easton, Wild and Halsey (Cambridge Business, 2005)
  - Financial Accounting: Introduction to Concepts, Methods and Uses, 11<sup>th</sup> Edition, by Stickney and Weil (South-Western, 2005)
- A corporate finance text:
  - Principles of Corporate Finance, 8<sup>th</sup> Edition, by Brealey, Allen and Myers (McGraw-Hill Irwin, 2005)

### **CLASS PARTICIPATION AND ATTENDANCE:**

Successful completion of this class will require extensive participation in class discussion and the presentation of answers to classroom exercises. Class members are required to read all of the assigned exercises/problems/requirements and to prepare the material as requested.

At his discretion, the instructor may ask a student to present his/her material to the class for discussion. You are expected to participate in the discussions either as a presenter or as a member of the audience, so daily preparation is required.

Attendance at all class meetings is expected. You are responsible for all announcements, syllabus revisions, assignments, and any other material discussed in all class meetings.

### **STUDENTS WITH DISABILITIES:**

Any student having a disability that may affect his/her performance in this course should alert the instructor as soon as possible. To request disability accommodations, please contact the Office of Disability Services at 348-4285 (133-B Martha Parham West). After initial arrangements are made with that office, contact the instructor.

### **ACADEMIC DISHONESTY:**

Students enrolled in this course are expected to abide by the academic honor code of the University. Acts of academic dishonesty will not be tolerated, and will be dealt with in accordance with University guidelines.

The Honor Code: All students in attendance at The University of Alabama are expected to be honorable and to observe standards of conduct appropriate to a community of scholars. The University of Alabama expects from its students a higher standard of conduct than the minimum required to avoid discipline. At the beginning of each semester and on examinations and projects, the professor, department, or division may require that each student sign the following Academic Honor Pledge: "I promise or affirm that I will not at any time be involved with cheating, plagiarism, fabrication, or misrepresentation while enrolled as a student at The University of Alabama. I have read the Academic Honor Code, which explains disciplinary procedure resulting from the aforementioned. I understand that violation of this code will result in penalties as severe as indefinite suspension from the University."

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### **MIDTERM EXAM:**

There will be two take home open book and note midterm exams on October 5 (Wed.) and November 4 (Wed.). Everyone is expected to take exams at the same time. In general, there are no make-up exams. Should conflicts arise under unexpected situations, contact the instructor as soon as possible so that other arrangements can be made.

The exams will consist of short questions on text readings, class discussions, and problems similar to those covered in class. Most questions will consist of problems requiring calculations or essay questions in order to test the critical thinking skills of each student.

Should a student believe that his/her examination has been incorrectly graded, he/she has five school days in which to bring the matter to the instructor's attention. To do so, the student must clearly describe the nature of the complaint in writing and provide references to sources that the student believes support his/her position. Such a process is required to prevent the instructor from "misreading" a student's intended response or misunderstanding.

### **TAKE HOME MULTIPLE CHOICES:**

During the semester a take home multiple choice exams will be distributed. This exam will account for 20% of your final grade. The exam will cover financial accounting topics that are covered on the CPA exam. Most if not all of this material will not explicitly be covered in this class but has been covered in earlier accounting courses.

### **GROUP VALUATION PROJECT:**

You will need to form a group of four students. I reserve the right to add or remove group members, if necessary.

You will be required to deliver a project that involves financial analysis and uses tools developed in the course for few public firms. Each group will give a presentation and turn in a written report for the project. Clearly, a group project should be more ambitious than an individual project. More details about the project will be distributed and discussed in class.

**GRADING:**

Midterm Exam I	25%
Midterm Exam II	30%
Take Home Multiple Choice	20%
Group Valuation Project	<u>25%</u>
	100%

At the instructor's discretion, up to 2% may be added to student's total above, based on substantive contributions to class discussions on a regular basis. The following scale is used at the end of the semester to determine your standing in the course.

90.0% or greater	A
80.0 – 89.9%	B
70.0 – 79.9%	C
60.0 – 69.9%	D
Less than 60.0%	F

## TENTATIVE SCHEDULE

<u>Date</u>	<u>(Day)</u>	<u>Required reading to be completed prior to class</u>
August 19	(W)	Introduction
August 24	(M)	Chapter 1
August 26	(W)	Chapter 2
August 31	(M)	Chapter 3
September 2	(W)	Chapter 4
<b>September 7</b>	<b>(M)</b>	<b>Labor Day Holiday – No Class</b>
September 9	(W)	E&Y (time and placed to be announced)
September 14	(M)	Chapter 5
September 16	(W)	In Class Valuation Example
September 21	(M)	Proctor and Gamble
September 23	(W)	Chapter 5
September 28	(M)	Chapter 6
September 30	(W)	Chapter 6
October 5	(M)	Chapter 7
<b>October 7</b>	<b>(W)</b>	<b>Midterm Exam I</b>
October 12	(M)	Chapter 8
October 14	(W)	Chapter 9
October 19	(M)	Chapter 10
October 21	(W)	Chapter 11
October 26	(M)	Chapter 12
October 28	(W)	Chapter 13
November 2	(M)	Chapter 15
November 4	(W)	Chapter 15
<b>November 9</b>	<b>(M)</b>	<b>Midterm Exam II</b>
November 11	(W)	Chapter 14
November 16	(M)	Chapter 18
November 18	(W)	Current research and applications of accounting based valuation
<b>November 23</b>	<b>(M)</b>	<b>Multiple Choice Take Home Exam</b>
November 25	(W)	Thanksgiving Holiday – Classes Dismissed
November 30	(M)	Presentations for the group valuation project
December 2	(W)	Presentations for the group valuation project

**Written report for the group valuation project due at noon on November 16.**

Tentative Final Exam – 9:30 class – Thursday, 12/10/2009, 8:00 – 10:30 a.m.

Tentative Final Exam – 11:00 class – Friday, 12/11/2009, 8:00 – 10:30 a.m.