

**Commerce 4AX3**  
**Earnings Quality and Equity Valuation**  
**Winter 2010 Course Outline**

**Accounting and Financial Management Services Area**  
**DeGroote School of Business**  
**McMaster University**

<b>COURSE OBJECTIVE</b>
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The focus of this course is on using the information contained in earnings for evaluating the performance of a business, and for assessing its prospects and value.

<b>INSTRUCTOR AND CONTACT INFORMATION</b>
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**Course Website:** <http://elm.mcmaster.ca>

<b>COURSE ELEMENTS</b>
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Credit Value:	3	Leadership:	No	IT skills:	Yes	Global view:	Yes
ELM:	Yes	Ethics:	Yes	Numeracy:	Yes	Written skills:	Yes
Participation:	Yes	Innovation:	No	Group work:	Yes	Oral skills:	Yes

## Course Description

This course will focus on the use of financial statements for equity valuation. It will give you the opportunity to combine the knowledge and skills that you have acquired in previous courses to assess the quality of a firm's earnings and using this knowledge for assessing its prospects and value.

Cases and projects are used to develop and integrate the business analysis and valuation concepts. Healthy scepticism is emphasized, as students are encouraged to challenge the assumptions and facts related to each issue.

After the completion of this course, students should understand and appreciate some of the rationales and characteristics that underlie business practices and financial reporting. Students should also appreciate the myriad interactions among the process of business analysis and valuation, the use of information sets (accounting and non-accounting), and the workings of the capital markets.

## Course Materials

Text: Palepu and Healy, **Business Analysis and Valuation Using Financial Statements**, 4th edition (South-Western Publishing Co., 2008)

## Course Grade

Course grades will be based on the following:

Homework Assignments	20%
Class Participation	20%
Term Project	30%
Mid-term Exam	<u>30%</u>
Total	<u>100%</u>

## Homework Assignments

Homework assignments consist of a typewritten analysis of the key facts and issues of four cases covered in class along with your conclusions/recommendations. For each assignment, I will prepare a set of questions to help you focus your analysis as well as to identify issues around which class discussion will be focused. Case write-ups **should not exceed three pages**. When appropriate, you may include additional pages of tables or calculations to support your conclusions. These pages must be clearly labelled and understandable. This is a group assignment. Only one write-up per group is required to be submitted. You should use a 12-point font and double spacing for your typewritten responses.

Assignments will be collected at the beginning of the class to which they relate. **No late assignments will be accepted.**

## **Term Project**

The term project serves as a synthesizing device for the course. It is a group project which requires you to select two publicly listed firms (a large-cap and a small-cap) from a non-financial industry, summarize the economics, current conditions, key success factors and risks in the industry, evaluate the strategies each of the firms pursues, identify accounting issues relevant to the analysis, perform a financial analysis, prepare forecasts and using these forecasts value the common stock using alternative valuation methods, and recommend whether to buy or sell each firm's stock.

You are required to submit an interim report (maximum 7 pages) covering strategy analysis and accounting analysis for the two firms **on or before February 23rd**. Your final report should not exceed 15 pages, excluding tables, graphs, appendices and references. In addition, it should include the most recent financial statements for the companies you analyzed. Two copies of your written reports are to be handed in at the start of the last class. Typewritten reports should be 12-point, double-spaced. Each group will be scheduled to present its project to the class during the last class session.

## **Class Participation**

The success of this class depends on your preparation for and participation in class discussion. To provide incentives for you to do so, 20 percent of your course grade is based on class participation. Voluntary class participation is expected; however, I will also call on you to discuss issues related to the assigned readings and cases. The emphasis in class discussion is neither on quantity nor on having the "right answer." Typically, there is no single "right" solution to many business problems, but there is always something to be gained from examining a variety of well-reasoned viewpoints. My basic standard for class participation is that it reflects adequate and thoughtful preparation for class. I also encourage you to bring to the attention of the class articles from Financial Post, The Wall Street Journal or other business periodicals that are relevant to the topics covered in this course.

## **MID-TERM EXAM**

The mid-term exam is an open-book, in-class exam (Date TBA).

## **POLICY ON MISSED MID-TERM EXAMINATIONS / TESTS**

Where students miss a regularly scheduled midterm for legitimate reasons as adjudicated by the Academic Programs Office (APO), the weight for that test will be distributed across other evaluative components of the course at the discretion of the instructor. Documentation

explaining such an absence must be provided to the APO within five (5) working days upon returning to school. The approved McMaster Medical Form must be used to document absence for health related reasons. If an exam is missed without a valid reason, students will receive a grade of Zero (0) for that component. University policy states that a student may submit a maximum of three (3) medical certificates per year after which the student must meet with the Director of the program. Please see the following URL for APO forms:

<http://www.degroote.mcmaster.ca/UG/register.html>

Students unable to write at the posted exam time due to the following reasons: religious; work-related (for part-time students only); representing university at an academic or varsity athletic event; and conflicts between two overlapping scheduled midterm exams, have the option of applying for special exam arrangements. Such requests must be made to the APO at least ten (10) working days before the scheduled exam along with acceptable documentation. There will be only one common sitting for the special exam. Instructors cannot themselves allow students to unofficially write make-up exams/tests. Adjudication of the request must be handled by the APO.

## GRADE CONVERSION

At the end of the course your overall percentage grade will be converted to your letter grade in accordance with the following conversion scheme.

LETTER GRADE	PERCENT	LETTER GRADE	PERCENT
A+	90 - 100	C+	67 - 69
A	85 - 89	C	63 - 66
A-	80 - 84	C-	60 - 62
B+	77 - 79	D+	57 - 59
B	73 - 76	D	53 - 56
B-	70 - 72	D-	50 - 52
		F	00 - 49

## ACADEMIC DISHONESTY

It is the student's responsibility to understand what constitutes academic dishonesty. Please refer to the University Senate Academic Integrity Policy at the following URL:

<http://www.mcmaster.ca/univsec/policy/AcademicIntegrity.pdf>

This policy describes the responsibilities, procedures, and guidelines for students and faculty should a case of academic dishonesty arise. Academic dishonesty is defined as to knowingly act or fail to act in a way that results or could result in unearned academic credit or advantage. Please refer to the policy for a list of examples. The policy also provides faculty with procedures

to follow in cases of academic dishonesty as well as general guidelines for penalties. For further information related to the policy, please refer to the Office of Academic Integrity at:

<http://www.mcmaster.ca/academicintegrity>

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<http://library.mcmaster.ca/about/copying.pdf>

## STUDENTS WITH DISABILITIES

Students with disabilities are required to inform the Centre for Student Development (CSD) of accommodation needs for examinations on or before the last date for withdrawal from a course without failure (please refer to official university sessional dates). Students must forward a copy of such CSD accommodation to the instructor immediately upon receipt. If a student with a disability chooses NOT to take advantage of a CSD accommodation and chooses to sit for a regular exam, a petition for relief may not be filed after the examination is complete. The CSD website is:

<http://csd.mcmaster.ca>

## POTENTIAL MODIFICATIONS TO THE COURSE

The instructor and university reserve the right to modify elements of the course during the term. The university may change the dates and deadlines for any or all courses in extreme circumstances. If either type of modification becomes necessary, reasonable notice and communication with the students will be given with explanation and the opportunity to comment on changes. It is the responsibility of the student to check their McMaster email and course websites weekly during the term and to note any changes.

<b>COURSE SCHEDULE</b>
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<b><u>CLASS SESSION</u></b>	<b><u>TOPICS, READINGS, ASSIGNMENTS</u></b>
<b>1</b>	<p><b>Introductions</b></p> <p><b>Framework for Business Analysis and Valuation</b>  <b>Reading:</b> Chapter 1</p>
<b>2</b>	<p><b>Strategy Analysis</b>  <b>Reading:</b> Chapter 2</p> <p><b>Strategy Analysis</b>  <b>Case Assignment:</b> America Online, Inc.</p>
<b>3</b>	<p><b>Accounting Analysis</b>  <b>Reading:</b> Chapter 3</p>
<b>4</b>	<p><b>Accounting Analysis</b>  <b>Reading:</b> Chapter 3</p> <p><b>Accounting Analysis</b>  <b>Case Assignment:</b> Harnischfeger Corporation</p>
<b>5</b>	<p><b>Implementing Accounting Analysis</b>  <b>Reading:</b> Chapter 4</p>
<b>6</b>	<p><b>Implementing Accounting Analysis</b>  <b>Case Assignment:</b> Pre-Paid Legal Services, Inc.</p> <p><b>Financial Analysis</b>  <b>Reading:</b> Chapter 5</p>

<b><u>CLASS SESSION</u></b>	<b><u>TOPICS, READINGS, ASSIGNMENTS</u></b>
7	<b>Financial Analysis</b> <b>Case Assignment:</b> The Home Depot, Inc.  <b>Forecasting</b> <b>Reading:</b> Chapter 6
8	<b>Forecasting</b> <b>Case Assignment:</b> Krispy Kreme Doughnuts  <b>Valuation</b> <b>Reading:</b> Chapters 7 and 8
9	<b>Valuation</b> <b>Reading:</b> Chapters 7 and 8
10	<b>Mid-term Exam</b>
11	<b>Valuation</b> <b>Case Assignment:</b> Home Depot, Inc. in the New Millennium
12& 13	<b>Project Presentations</b> <b>Assignment:</b> Hand in term projects (2 copies)