

Financial Statement Analysis

ESCP Paris, Fall 2013

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Course Content

This course provides a framework for analyzing financial statements for different analytical purposes. It presents a variety of targeted tools and techniques for analysis and interpretation of financial statements. It helps students to learn to think critically when analyzing financial data and to make different decisions based on user-group objectives (equity, credit and management analysts).

The 2008 crisis has revealed new forms of financial risk and recalled the need for decision makers to carry out a rigorous approach of financial analysis; it is the duty of all investors and managers to analyze the products they are investing in. It also pointed out the need to include extra-accounting information when analyzing company's financial health.

This course argues that (i) there is no single indicator of good health; a rigorous financial analysis requires a combination and a cross-analysis of different indicators covering several aspects to good financial health. (ii) Financial ratios are not very helpful by themselves; they need to be compared to something: an appropriate benchmark (time-trend analysis, comparison with competitors and industry peers, etc.). (iii) Focusing only on numbers is insufficient; analysts need to be aware of the organization's business strategy, understand the nature of the industry in which the organization operates, as well as the overall state of the economy that may impact the performance of the organization.

First, we focus on cash flows and place emphasis on the critical importance of the operating cycle, including the notion of working capital. Second, we present the basic concepts and tools required to conduct a financial statement analysis. We suggest the following financial analysis guideline: (i) strategic and economic assessment, (ii) growth analysis, (ii) profitability analysis, (iv) risk analysis, and (v) conclusions and recommendations.

Learning Objectives

After this course you should be able to:

- Know why the disclosure of financial information through financial statements is critical to investors
- Understand the construction of the main financial statements and discuss their limitations
- Use accounting information to construct financial ratios
- Distinguish between accounting analysis (accrual-based measures, book value) and financial analysis (Cash-based measures, market value) of the firm
- Evaluate the sustainability of growth (in EVA) and the quality of earnings: assess the process of value creation
- Understand the relationship between operating profitability (ROCE) and owner's profitability (ROE), as well as the impact of financial leverage on profitability.
- Assess illiquidity and solvency risk.
- Write a Financial Analysis Report

Indicative outline

1. Introduction: fundamental concepts
2. Classifying Company Cash Flows: the Operating Cycle is of critical importance
3. Balance Sheet: A Reminder
4. The analytical Balance sheet: the Financial View
5. The analytical Income Statement: Assessing Earnings Quality
6. Accrual-based Versus Cash-Flow-based performance measures
7. Profitability and illiquidity Risk Analysis
8. Writing a Financial Analysis Report: Carlsberg Case Study

Students session: presentation of Financial Analysis Report of the company of your choice (groups of 4)

Reference Books

Pierre Vernimmen (2013), Corporate Finance: Theory and Practice, 3rd Edition. With Pascal Quiry, Yann Le Fur, Antonio Salvi, Maurizio Dallochio. John Wiley & Sons Ltd.

Thomas Plenborg, Christian Petersen (2012), Financial Statement Analysis: Valuation - Credit Analysis - Executive Compensation. Financial Times Press.

Berk Jonathan and DeMarzo Peter (2011), Corporate Finance, Pearson Education, 2nd Edition.

Christophe Thibière (2011), Analyse financière, 4ème édition, Vuibert.

Assessments

	% of total grade
Quiz	20%
In class	
At the beginning of session 4	
20 minutes	
Closed book	
Financial Analysis Report presentation	20%
Homework - groups of 4	
Presentation in class (Session 5)	
Final exam	60%
Closed book	
2 hours	
Total Class Grade	100%

Tentative course schedule

	Chapters	Exams
Lecture 1	1. Introduction: fundamental concepts	
Lecture 2	2. Classifying Company Cash Flows: the Operating Cycle is of critical importance 3. Balance Sheet: A Reminder 4. The analytical Balance sheet: the Financial View	
Lecture 3	5. The analytical Income Statement 6. Accrual-based Versus Cash-Flow-based performance measures	
Lecture 4	7. Profitability and illiquidity Risk Analysis 8. Writing a Financial Analysis Report: Carlsberg Case Study	Quiz In class At the beginning of session 4 20 minutes Closed book
Lecture 5	Students session: presentation of Financial Analysis Report of the company of your choice (groups of 4)	Financial Analysis Report presentation Homework - groups of 4 Presentation in class