

## Course information 2023-24

# AC3143 Valuation and securities analysis

### General information

**COURSE LEVEL:** 6

**CREDIT:** 30

**NOTIONAL STUDY TIME:** 300 hours

### Summary

This course provides insights and understanding of security analysis and valuation from both theoretical and empirical perspectives. It is aimed at students who are interested in equity research, corporate finance and fund management.

### Conditions

**Prerequisites:** If taken as part of a BSc degree, the following course(s) must be attempted before you can register on this course.

- FN1024 Principles of banking and finance
- **and** AC1025 Principles of accounting.

### Aims and objectives

This course is aimed at students interested in equity research, corporate finance, and fund management. It is designed to provide the tools, drawn from accounting, finance, economics, and strategy, required to:

- analyse the performance of securities
- value securities
- assess returns on active investment strategies.

Furthermore, it provides empirical evidence on returns to fundamental and technical analysis.

### Learning outcomes

At the end of the course and having completed the essential reading and activities students should be able to:

- carefully analyse the financial performance of given securities and critically review equity research published by financial analysts
- competently apply valuation technologies required in corporate finance with minimum guidance
- critically assess third-party valuation reports
- recall main insights and key facts of the fund management industry

Please consult the current EMFSS Programme Regulations for further information on the availability of a course, where it can be placed on your programme's structure, and other important details.

- clearly recognize the difficulties associated with measuring abnormal returns in fundamental and technical analysis.

## Essential reading

For full details please refer to the reading list.

Palepu, K., V. Bernard and P. Healy. *Business Analysis & Valuation*. (South-Western College Publishing) fifth international edition [ISBN 9781133434863].

Penman, S. *Financial Statement Analysis & Security Valuation*. (McGraw-Hill) fifth edition [ISBN 9780071326407].

## Assessment

This course is assessed by a three-hour and fifteen-minute closed-book written examination.

## Syllabus

*The analysis framework and financial statements*

*Introduction to the analysis framework using financial statements.* The setting: investors, firms, securities and financial markets. The framework for analysis. Business strategy analysis. Industry analysis. Competitive strategy analysis. Sources of competitive advantage. Achieving and sustaining competitive advantage. Accounting analysis. Financial analysis. Prospective analysis.

*Introduction to stylised financial statements.* Stylised profit and loss, balance sheet and cash flow statements. Accounting relations governing the stylised financial statements.

*Financial analysis: performance evaluation.* Concept of comprehensive earnings. Earnings and stock returns. Bottom-line profitability. Cost of equity capital. Concept of residual earnings. Accounting rates of return and stock rates of return.

*Financial analysis: the determinants of performance.* Business profitability. Economic value added. Link between business and bottom-line profitability. Determinants of business profitability. Business profitability and free cash flows.

*Accounting and strategy analysis.* Overview of the institutional setting. Industry analysis. Corporate strategy analysis. Sources of competitive advantage. Accounting analysis. Factors influencing accounting quality. Assessing the quality of accounting

*Prospective performance evaluation and valuation.* Forecasting: simple forecasting and full information forecasting. Empirical evidence on the behaviour of accounting rates of return, residual earnings, economic value added, and financial leverage. A full-information forecasting template.

*Securities valuation.* Introduction to valuation methods based on dividends, free cash flows, residual earnings and economic value added. Inferences on valuation accuracy. Comparison of valuation methods: empirical evidence.

*Implications for price-to-earnings and price-to-book ratios.* Determinants of price-to-book ratios. Residual earnings growth. Determinants of price-to-earnings ratios. Empirical evidence. Strategic taxonomy. Implications of strategic taxonomy for price-to-book and price-to-earnings ratios. Empirical evidence on the joint distribution of price-to-book and price-to-earnings ratios.

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*Financial information and stock prices.* Usefulness of earnings to investors: the empirical evidence from capital markets research. Earnings response coefficients. Competing hypotheses to explain the earnings response conundrum. Fundamental information analysis and stock prices.

*Applications.* Internet stock. Financial measures vs usage measures in the valuation of internet stocks. A time trend analysis of the relative importance of financial vs usage measures.

*Mergers and acquisitions.* Motivation for mergers and acquisitions. Strategic and financial analysis of mergers and acquisitions. Acquisition pricing. Accounting issues. Acquisition financing. Acquisition outcome.

*Returns to fundamental analysis.* Contrarian strategies. Implications of current earnings for future earnings. Do stock prices fully reflect information in accruals and cash flows about future earnings? Earnings management and the long run performance of IPOs.

*Returns to technical analysis.* Contrarian strategies. Momentum strategies. Reconciliation of empirical evidence.

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