

APPLIED VALUATION AND SECURITIES ANALYSIS (AC315)

Course duration: 54 hours lecture and class time (Over three weeks)

LSE Teaching Department: Department of Accounting

Lead Faculty: Dr Vasiliki Athanasakou and Dr Jose Carabias Palmeiro

Pre-requisites: Introductory accounting (including basic financial analysis) and finance

Course Aims and Learning Outcomes:

In the first part, this applied equity research course adopts a case-study approach to value stocks and companies using financial statements. Special attention will be dedicated to initial public offerings (IPO) and to valuing young, fast-growing companies with few clear comparables. The course includes a valuation-based IPO game in which students working in small groups are competing to advise on an IPO offering.

In the second part, the course helps students to develop a scientific approach towards fundamental analysis and understanding the main drivers of predictability in future stock returns. It introduces the basics for designing accounting-based trading strategies and provides empirical evidence on the returns to these strategies.

Brief Course Outline:

Topics covered in this course include the following ones:

- Applied valuation with special emphasis on key events such as initial public offerings and young and fast-growing companies:
 - Performance analysis, accounting quality, and implications for valuation;
 - Valuation methods;
 - Valuation and accounting strategies
- Common errors in company valuations and implications for efficient markets.
- Fundamental analysis:
 - Accounting, financial statement analysis, and trading strategies;
 - Empirical returns to investment strategies based on accounting fundamentals.

This course should hence appeal to students interested in equity research, corporate finance, asset management, and strategy consulting.

Core Text:

- “Valuation and Security Analysis”, by Beccalli and Frantz (2013). Students will be provided access to an electronic copy of this text.

This textbook is similar in level to “Financial Statement Analysis and Security Valuation”, by Penman, Mc Graw Hill, but includes chapters on empirical returns to fundamental and technical analysis.

This course also relies on case-studies, financial data, and journal articles.

Schedule of Lectures and Classes:

Week 1	Morning	Afternoon
Monday		Lecture 1
Tuesday	Class 1	Lecture 2
Wednesday	Class 2	Lecture 3
Thursday	Class 3	Lecture 4
Friday	Class 4	Lecture 5
Week 2	Morning	Afternoon
Monday	Class 5	Lecture 6
Tuesday	No class	No lecture
Wednesday	Class 6	Lecture 7
Thursday	Class 7	Lecture 8
Friday	Class 8	Lecture 9
Week 3	Morning	Afternoon
Monday	Class 9	Lecture 10
Tuesday	Class 10	Lecture 11
Wednesday	Class 11	Lecture 12
Thursday	Class 12	Lecture 12
Friday	Final Exam* Exams may be scheduled at any time between 9am – 5pm on these days.	

Detailed Course Outline

Lecture 1: Introduction to Applied Valuation

Introduction to “Applied Valuation and Securities Analysis”. Introduction to the valuation in an IPO setting case: Facebook Inc. The role of industry analysis.

Core Readings:

- Chapter 2 [*Valuation and Securities Analysis* (Beccalli and Frantz)].

Case Study:

- Facebook Inc. The initial public offering

Lecture 2: Basics of Securities Valuation

Reviewing and applying the basic steps of valuation models (including the residual income or abnormal earnings valuation model).

Core Readings:

- Chapters 3 and 8 [*Valuation and Securities Analysis* (Beccalli and Frantz)].

Case Study:

- Coca Cola Residual Income Valuation

Lecture 3: Prospective Analysis and Valuation Implementation

Full information forecasting, forecast horizon, terminal value assumptions, drivers of abnormal profitability.

Core Readings:

- Chapters 4 and 7 [*Valuation and Securities Analysis* (Beccalli and Frantz)].

Case Study:

- Coca Cola Residual Income Valuation

Lecture 4: Financial Analysis and Valuation

Financial analysis, ratios, sell-side analyst valuations.

Core Readings:

- Chapters 4 and 5 [*Valuation and Securities Analysis* (Beccalli and Frantz)].

Case Study: Ryanair Holdings PLC

Lecture 5: Accounting and Analysis Valuation

Detecting and adjusting for accounting bias in valuation.

Core Readings:

- Chapter 6 [*Valuation and Securities Analysis* (Beccalli and Frantz)].

Case Study:

- Monmouth Inc

Lecture 6: Valuations in Special Settings

Valuing early stage and high growth companies. Valuation in an IPO setting.

Core Readings:

- Chapter 10 [The Dark Side of Valuation, Damodaran 2010 - chapter copy attached in coursepack].
- Damodaran, A. (2010). *The Dark Side of Valuation: Valuing young, distressed, and complex businesses* (2nd Edition). Pearson Education Ltd

Case Study:

- Monmouth Inc, LinkedIn Corporation

Lecture 7: Common Errors in Company Valuations: Implications for Market Efficiency

Errors in forecasting future earnings. Errors in forecasting future balance-sheet items. Errors in estimating long term-growth.

Core Readings:

- Fernández, Pablo, and Jose M., Carabias "96 Common Errors in Company Valuations." Available at SSRN (2006).

Supplementary Readings:

- Kothari, S. P. "Capital markets research in accounting." *Journal of Accounting and Economics* 31, no. 1 (2001): 105-231.
- Lee, Charles. "Market efficiency and accounting research: a discussion of 'capital market research in accounting by SP Kothari.'" *Journal of Accounting and Economics* 31, no. 1 (2001): 233-253.
- Lewellen, Jonathan. "Accounting anomalies and fundamental analysis: An alternative view." *Journal of Accounting and Economics* 50, no. 2 (2010): 455-466.
- Richardson, Scott, İrem Tuna, and Peter Wysocki. "Accounting anomalies and fundamental analysis: A review of recent research advances." *Journal of Accounting and Economics* 50, no. 2 (2010): 410-454.

Lecture 8: Fundamental Analysis and Active Investment

Stock prices and firm fundamentals. Forecasting as the key principle in fundamental-based active investment. Portfolio construction and backtesting. Performance Evaluation

Core Readings:

- Grinold, Richard C., and Ronald N. Kahn. "Active portfolio management." (2000). Chapters 14-17.

Lecture 9: The Mispricing of Earnings: Earnings, Momentum and Accrual Anomaly

Time-series process of quarterly earnings. Naïve market earnings expectations about the time-series properties of quarterly earnings. Standardize unexpected earnings and future stock returns. Delayed response to information or risk? Earnings components: accruals and cash-flows. Differential time-series properties of accruals and cash-flows. Naïve market earnings expectations about the time-series properties of accruals and cash-flows. Accruals and future stock returns. Earnings fixation or risk? Are earnings momentum and accrual anomaly different?

Core Readings:

- Bernard, Victor L., and Jacob K. Thomas. "Evidence that stock prices do not fully reflect the implications of current earnings for future earnings." *Journal of Accounting and Economics* 13, no. 4 (1990): 305-340.
- Sloan, Richard G. "Do stock prices fully reflect information in accruals and cash flows about future earnings?." *The Accounting Review* (1996): 289-315.
- Chapter 12 [*Valuation and Securities Analysis* (Beccalli and Frantz)].
- Supplementary Readings: Ball, Ray, and Eli Bartov. "How naive is the stock market's use of earnings information?." *Journal of Accounting and Economics* 21, no. 3 (1996): 319-337.
- Bernard, Victor L., and Jacob K. Thomas. "Post-earnings-announcement drift: delayed price response or risk premium?." *Journal of Accounting research* (1989): 1-36.
- Collins, Daniel W., and Paul Hribar. "Earnings-based and accrual-based market anomalies: one effect or two?." *Journal of Accounting and Economics* 29, no. 1 (2000): 101-123.
- Richardson, Scott A., Richard G. Sloan, Mark T. Soliman, and Irem Tuna. "Accrual reliability, earnings persistence and stock prices." *Journal of Accounting and Economics* 39, no. 3 (2005): 437-485.
- Xie, Hong. "The mispricing of abnormal accruals." *The Accounting Review* 76, no. 3 (2001): 357-373.

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Lecture 10: The Mispricing of Earnings and Book Values: The Net Operating Asset Anomaly

NOA components: accruals and long-term net operating assets. Differential time-series properties of accruals, long-term net operating assets and cash-flows. Naïve market earnings expectations about the time-series properties of NOA and cash-flows. NOA and future stock returns. Earnings fixation or diminishing marginal returns to investment or both?

Core Readings:

- Fairfield, Patricia M., J. Scott Whisenant, and Teri Lombardi Yohn. "Accrued earnings and growth: Implications for future profitability and market mispricing." *The Accounting Review* 78, no. 1 (2003): 353-371.
- Chapter 12 [*Valuation and Securities Analysis* (Beccalli and Frantz)].

Supplementary Readings:

- Hirshleifer, David, Kewei Hou, Siew Hong Teoh, and Yinglei Zhang. "Do investors overvalue firms with bloated balance sheets?." *Journal of Accounting and Economics* 38 (2004): 297-331

Lecture 11: The Mispricing of Long-term Growth: Contrarian investment and Naïve Extrapolation of Growth

Analysts' long-term earnings growth forecasts. Investors' naive reliance on analysts' growth forecasts. Price-to-earnings-ratio and future stock returns. Returns to buying stocks with low prices relative to earnings, cash-flows or book-values.

Core Readings:

- Dechow, Patricia M., and Richard G. Sloan. "Returns to contrarian investment strategies: Tests of naive expectations hypotheses." *Journal of Financial Economics* 43, no. 1 (1997): 3-27.
- Chapter 12 [*Valuation and Securities Analysis* (Beccalli and Frantz)].

Supplementary Readings:

- La Porta, Rafael, Josef Lakonishok, Andrei Shleifer, and Robert Vishny. "Good news for value stocks: Further evidence on market efficiency." *The Journal of Finance* 52, no. 2 (1997): 859-874.
- La Porta, Rafael. "Expectations and the cross-section of stock returns." *The Journal of Finance* 51, no. 5 (1996): 1715-1742.
- Lakonishok, Josef, Andrei Shleifer, and Robert W. Vishny. "Contrarian investment, extrapolation, and risk." *The Journal of Finance* 49, no. 5 (1994): 1541-1578.

Lecture 12: Extensions and Remarks

Enhancing the returns of existing trading strategies: the role of fundamental analysis (F-score and G-score). Combining earnings momentum and accrual anomaly. Revenue surprises and earnings momentum. Miss-specification in risk models. Portfolio composition, turnover and transaction costs. Data mining and look-ahead biases in back testing

Core Readings:

- Piotroski, Joseph D. "Value investing: The use of historical financial statement information to separate winners from losers." *Journal of Accounting Research* (2000): 1-41.

Supplementary Readings:

- Collins, Daniel W., and Paul Hribar. "Earnings-based and accrual-based market anomalies: one effect or two?." *Journal of Accounting and Economics* 29, no. 1 (2000): 101-123.
- Jegadeesh, Narasimhan, and Joshua Livnat. "Revenue surprises and stock returns." *Journal of Accounting and Economics* 41, no. 1 (2006): 147-171.
- Mohanram, Partha S. "Separating Winners from Losers among Low Book-to-Market Stocks using Financial Statement Analysis." *Review of Accounting Studies* 10, no. 2-3 (2005): 133-170.
- Basu, Sudipta. "What do we learn from two new accounting-based stock market anomalies?." *Journal of Accounting and Economics* 38 (2004): 333-348.
- Grinold, Richard C., and Ronald N. Kahn. "Active portfolio management." (2000).

- Lewellen, Jonathan. "Accounting anomalies and fundamental analysis: An alternative view." Journal of Accounting and Economics 50, no. 2 (2010): 455-466.
- Richardson, Scott, İrem Tuna, and Peter Wysocki. "Accounting anomalies and fundamental analysis: A review of recent research advances." Journal of Accounting and Economics 50, no. 2 (2010): 410-454.

Credit Transfer: If you are hoping to earn credit by taking this course, it is advisable that you confirm it is eligible for credit transfer well in advance of the start date. Please discuss this directly with your home institution or Study Abroad Advisor.

As a guide, our LSE Summer School courses are typically eligible for three credits within the US system and 7.5 ECTS in Europe. Different institutions and countries can, and will, vary. You will receive a digital transcript and a printed certificate following your successful completion of the course in order to make arrangements for transfer of credit.

If you have any queries, please direct them to summer.school@lse.ac.uk