

# SEMINAR OVERVIEW

## APPLIED ANALYTICS

BARRY M FROHLINGER, INC.

# APPLIED ANALYTICS

The Applied Analytics seminar builds upon the prerequisite understanding of financial statement *reporting* (financial accounting) and develops the ability to perform an analysis of a company's financial information that is useful for decision making.

The Applied Analytics seminar enhances knowledge of the interrelationships among the financial statements (both for complete statements and for specific elements of the statements) and develops analytical techniques that can be performed to "open up" the financial information for the user.

*Considerable attention is given to developing an ability to identify the underlying economic reality for a company and to assessing how well the accountant's measurements reflect this reality.* The ability to distinguish (i) between profits and cash flows and (ii) between book amounts and market values is developed. The ability to recast the balance sheet, income statement and statement of cash flow is critical. The Application of Corporate Finance techniques is practiced.

Attention is given to developing an intellectual inquisitiveness combined with judgment about the importance of issues identified by analysis.

The financial statement analysis techniques developed are used for various decisions including assessing a company's financing needs, validating the reliability of projections of future cash flows, assessing a company's debt rating [given an existing capital structure or a change in the capital structure] and performing corporate valuations.

# 1 OBJECTIVES OF FINANCIAL STATEMENT ANALYSIS

- ◆ Interrelationship of Financial Accounting, Applied Analytics and Credit, Risk, Capital Market, and Equity Analysis
- ◆ Importance and limitations of financial statements

# 2 ANALYSIS OF INCOME STATEMENT

- ◆ **Timing of revenue recognition**
  - does revenue measure the economic reality?
  - problem of collectibility
  - timing of revenue recognition
  - contractual accounting and backlog
  - shipments to dealers
- **Cost matching**
  - does expense measure the economic reality?
  - product costs (including Lifo method)
  - depreciation and amortization
  - research and development
  - intangibles amortization [Finite vs. Indefinite]
  - goodwill amortization
  - capitalized interest
  - pension costs and other postretirement benefits

Cases: Campbell Soup, Pfizer, O.M. Scott, Bausch & Lomb, Xerox

# 1 ANALYSIS OF INCOME STATEMENT

- Recasting of Income Statement (to segregate unusual items)
- Timing of revenue recognition and cost matching
- Analysis and Interpretation of
  - Income taxes
    - loss carrybacks and carryforwards
    - current and deferred disclosure
  - Extraordinary gains & losses
  - Accounting Changes
  - EPS
  - Segment reporting
  - Management's Discussion and Analysis
  - Quality of earnings
  - Level versus trend of earnings
- Income smoothing
- Comprehensive income

Cases: Deere, Exxon/BP/Wal-Mart, Haverty Furniture, Witco Chemical

### 1 ANALYSIS OF INCOME STATEMENT

- F/X
  - foreign currency transactions & translations
  - temporal versus all current rate
- Manufacturing Under Contract
- Stock Options

### 2 ANALYSIS OF INTERCORPORATE INVESTMENTS & BUSINESS COMBINATIONS and DISCONTINUED OPERATIONS

- Consolidated financial statements
- Minority interests
- Equity method
- Accounting for business combinations
- Goodwill (on and off balance sheet)
- Purchase vs. pooling--effects on consolidated statements
- Discontinued operations

Cases: Deere, Kimberly-Clark, Intel

## SESSION 4

### 1

#### ANALYSIS OF STATEMENTS OF CASH FLOWS

- Understanding the interrelationships of the operating cash flows with the Income Statement and Balance Sheet amounts
- Improving the Statements of Cash Flows for analysis
- Analyzing operating cash flows (indirect method)
- Identifying the effects of business activities in Statements of Cash Flow

Cases: Deere, Campbell Soup

## SESSION 5

### 1

#### REVIEW

- ♦ Practice work on Kimberly-Clark and DaimlerChrysler

## SESSION 5A

### 1

#### QUIZ

## SESSION 6

### 1 ANALYSIS OF THE BALANCE SHEET – Assets

How does the accountant's measurement differ from economic reality:

- Cash and marketable securities
- Receivables and the allowance
- Inventories
- Long-term investments, including leasing assets
- Tangible fixed assets
- Wasting assets
- Intangible assets
- Prepaid expenses, deferred charges and deferred tax assets
- Working capital as a measure of liquidity
- Use of ratios in financial statement analysis
- Use of transaction analysis in financial statement analysis

Cases: Deere, Campbell Soup

## SESSION 7

### 1 ANALYSIS OF THE BALANCE SHEET – Operating Liabilities

How does the accountant's measurement differ from economic reality:

- Pension plan liabilities
- Accrued liabilities
- Postretirement benefits other than pensions
- Deferred credits (income)
- Deferred income taxes
- Reserves and provisions
- Contingent liabilities
- Commitments
- Off-balance sheet obligations and risk

Cases: Deere, Campbell Soup, Sudbury

## SESSION 8

### 1 ANALYSIS OF THE BALANCE SHEET – Debt and Equity

- Capital structure analysis
- Lease obligations: on- and off- balance sheet
- Leverage analysis
- Book value and market value of common equity
- Solvency and coverage ratios
- Derivatives

Cases: Deere, Campbell Soup

## SESSION 9

### 1 REVIEW

- ♦ Practice work on Kimberly-Clark and DaimlerChrysler

## SESSION 9A

### 1 QUIZ

## SESSION 10

### 1 CHANGES IN ACCOUNTING

- Identify GAAP [and the role of the auditor]
- Does GAAP reflect the economic reality?
- Analytical adjustment needed
- Implications for analysis

### 2 INTERCORPORATE INVESTMENTS & BUSINESS COMBINATIONS and DISCONTINUED OPERATIONS

- Consolidated financial statements
- Mechanics of Proforma Adjustments

Case: Sherwin-Williams

## SESSION 11

### 1 ANALYSIS OF RETURN ON INVESTMENT and ANALYSIS OF RESULTS OF OPERATIONS

- Significance of return on investment
- Analysis and interpretation of return on investment
- Analysis and interpretation of return on shareholders' equity
- Significance of profitability
- Does GAAP (for income statement) measure economic reality?
- Analysis of components of income statement
- Analysis of segment information
- Using Management's Discussion and Analysis "Results of Operations")
- Analysis of gross margin
- Evaluation of the quality of earnings
- Evaluation of the earnings level and trend

Case: Deere

## SESSION 12

### 1 ANALYSIS OF SHORT TERM LIQUIDITY AND CASH FLOWS

- Improving the cash statement
- Significance of short-term liquidity
- Importance of cash flow information
- Measures of liquidity (including ratios)
- Evaluation of liquidity
- Using Management's Discussion and Analysis ("Financial Condition")
- Projecting changes in conditions or policies
- Evaluation of cash statements

Cases: McDonald's, FDX, Apple Computer, Deere

## SESSION 13

### 1 ANALYSIS OF CAPITAL STRUCTURE AND LONG-TERM SOLVENCY

- Significance of capital structure
- Measurement of capital structure and financial leverage
  - (including ratios)
- Evaluation of capital structure
- Measurement of earnings (fixed charges) coverage
- Interpretation of earnings-coverage ratio
- Evaluation of long-term solvency
- Rating of debt obligations
- Ratios as predictors of business failure

Cases: Hollywood Park, Deere

## SESSION 14

### 1 APPLIED CORPORATE FINANCE AND INTERPRETING THE DRM

- Mechanics and implications of Debt Rating Models
- Implications of Debt Ratings
- Financing Choices
- Cost of Debt
- Cost of Preferred Stock
- Cost of Equity
  - Beta
  - CAPM
- WACC
- Valuation
  - Discounted cash flows
  - EBITDA multiples
  - P/E
  - Book and market values/debt and equity

Cases: Products Research & Chemical Corporation, Deere, Circuit City

## SESSION 15

### 1 APPLIED CORPORATE FINANCE APPLICATIONS

- Overall Seminar review with two case applications: Blockbuster and Quaker State

## SESSION 16

### 1 EXAM

Full Case Analysis

## SESSION 16A

### 1 REVIEW OF EXAM RESULTS