

ACCOUNTING

Financial Statement Analysis and Valuation

Answering time 4 hours

Course number: 2163

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Instructor: Jonas Spohr

Calculator allowed

Assuming they are the right sentences, ten sentences per question should be more than enough to answer questions one to four. To get the maximum points in question five, the answer should include calculations. There is no extra question for the students that took the course and made the assignments last year, so also for you it is enough to answer the five questions below.

Good luck!

1. Mention five "red flags" that may point toward questionable accounting quality.
(10 points)
2. Explain how you would get started in making a forecast to be used in equity valuation.
(10 points)
3. Describe how leverage is affecting a company's return on equity (ROE).
(15 points)
4. Abnormal earnings are assumed to follow an autoregressive model (according to the book the coefficient in this model has been on average 0.6 in the US). Explain what this autoregressive model means and give a couple of examples of firm specific factors that may affect its strength (the value of the coefficient).
(15 points)
5. Now, at the start of year 1, a company has equity of 10 and its net income for the three coming years are 5 (year 1), 5 (year 2) and 4 (year 3). The company is liquidated in the end of year 3 and at that point in time all equity is returned to the shareholders. The cost of equity is 10%. For year 1 and year 2 the firm pays 50% of its net income as dividends (the payment occurs in the end of the year). State the company's abnormal earnings for each year and calculate the value of the firm using the abnormal earnings model and the dividend discount model.
(20 points)