

**SIMON FRASER UNIVERSITY**  
*Faculty of Business Administration*

**Assignment #2**

BUS 417-3  
Security Analysis

25-3

**Academic Honesty:** This assignment is individual work. Students are required to follow requirements of S10.01 (see class webpage).

**Rules for Submission:** Answers to questions to be typed, single spaced, of maximum length 250 words each for questions #1 to #3. For questions with a) and b) parts, the sum of both these parts has to be contained within the total 250 word limit. Violations will be subject to deductions. Assignments are to be submitted in Word format to poitras7@sfu.ca, by the start of the lecture in week 10. Be sure to answer all parts of each question and to check spelling and grammar.

**Part I: ESSAY QUESTIONS. 8 pts. each (24 points total)**

1a) Philip Fisher makes the following observation in *Developing an Investment Philosophy* (1980):

“There are a relatively small number of truly outstanding companies. Their shares frequently can't be bought at attractive prices. Therefore, when favorable prices exist, full advantage should be taken of the situation. Funds should be concentrated in the most desirable opportunities ... For individuals (in possible contrast to institutions and certain types of funds), any holding of over twenty different stocks is a sign of financial incompetence. Ten or twelve is usually a better number ... As an individual's holdings climb toward as many as twenty stocks, it nearly always is desirable to switch from the least attractive of these stocks to more of the attractive.”

Comment on the implications of this statement for the management of a common stock portfolio and the relationship to two fund separation.

1b) Warren Buffett has observed:

“Academics ... like to define investment ‘risk’ differently, averring that it is the relative volatility of a stock or portfolio of stocks – that is, their volatility as compared to a large universe of stocks. Employing data bases and statistical skills, these academics compute with precision the ‘beta’ of a stock, its relative volatility in the past – and then build arcane investment and capital-allocation theories around this calculation. In their hunger for a single statistic to measure risk, however, they forget a fundamental principle: It is better to be approximately right than precisely wrong.”

Provide an assessment of the validity of this statement as well as a discussion of how the statement relates to process of determining an investment philosophy and making decisions in the face of uncertainty.

2) Graham and Dodd (1934) make the claim that: "All security analysis involves the analysis of financial statements". However, in some cases financial statements can have substantive limitations in revealing essential information required to arrive at an accurate assessment for security analysis purposes. With such potential difficulties in mind, identify potential limitations that appear in the financial statements of Netflix (NFLX) and SNAP (SNAP). (Hint: Be sure to identify and discuss the relevant financial statements, financial standards and line items involved.)

3) "The search for the 'correct' way to value common stocks, or even one that works, has occupied a huge amount of effort over a long period of time ... the implementation of a system to selectively value or select common stocks is a difficult task. This is a task that a valuation model purports to accomplish."

Describe the discounted dividend cash flow valuation models conventionally used to analyze common stocks. What are the implications of using alternative definitions of dividends? How do these models differ from valuation models that discount variables other than dividends? (Hint: Equations do not count toward the 250 word limit.)

**Part II: 6 points total (1 page maximum to answer all questions)**

i) Explain the difference between 'Goodwill' and 'Intangible assets' and provide a practical example of how a takeover could result in an increase for both items.

ii) Explain the difference between financing and operating leases and how the use of asset leasing versus debt financed asset purchases by Amazon would impact cash flow.

iii) Explain the different methods for calculating share repurchases and the implications for the cash flow statement and the balance sheet.

(Hint: It would be helpful to identify and discuss the relevant IAS and ASC numbers involved).