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(University of Choice)
**MASINDE MULIRO UNIVERSITY OF SCIENCE AND
TECHNOLOGY
(MMUST)**

MAIN/BUNGOMA/WEBUYE/KAPSABET/MUMIAS/NAIROBI CAMPUS

**UNIVERSITY EXAMINATIONS
2021 / 2022 ACADEMIC YEAR
THIRD YEAR SECOND SEMESTER**

**EXAMINATION
FOR THE DEGREE
OF
BACHELOR OF COMMERCE**

COURSE CODE: BCF 325

**COURSE TITLE: FINANCIAL STATEMENT
ANALYSIS**

DATE: Tuesday 19TH APRIL 2022 TIME: 3-5PM

INSTRUCTIONS TO CANDIDATES

Answer **QUESTION ONE** and **ANY OTHER TWO** questions.

TIME: 2 HOURS

MMUST observes **ZERO** tolerance to examination cheating
This Paper Consists of 3 Printed Pages. Please Turn Over. ▲

QUESTION ONE

- a) Discuss the statement “the nature of financial analysis varies according to the specific interest of the party involved” (5marks)
b) Industrial averages are used to benchmark in ratio analysis. Do you agree? (2marks)
- c) What is cross section analysis and how does it differ from time series analysis conducted by a financial analyst (3marks)
- d) Define and differentiate between return on total assets, return on equity and earnings per share. Which measure in your view is of greatest interest to owners, why? (5marks)
- e) Briefly explain how the following actions affect a firm’s current ratio. (2marks)
- Inventory is sold (2 marks)
 - The firm takes out a bank loan to pay its suppliers (2 marks)
 - A customer pays his overdue bills (2 marks)
 - The firm uses cash to purchase additional inventory (2 marks)

- f) Malaika Ltd and mwangaza Ltd are involved in Manufacturing. You have been presented with the following information relating to the two firms.

	Malaika Ltd		Mwangaza Ltd	
	Beginning	ending	Beginning	Ending
Accounts payable	700	650	900	1100
Accounts Receivable	370	440	1200	1800
Inventory	290	390	800	900
Sales		2060		4600
% of credit sales		70%		80%
Gross Margin		20%		15%

Required:

Which of the two firms have a longer cash cycle and what are the implications? (7 marks)

QUESTION TWO

- a) Two companies have the following financial characteristics in thousands:

	Company A	Company B
Working Capital	12000	-5500
Total Assets	54000	23000
Total Liabilities	25000	15000
Market value of equity	40000	6000
Retained Earnings	20000	4000
Sales	90000	28000
EBIT	15000	2200

Using Altman’s model for predicting bankruptcy, determine the Z-score index for each company and comment on their probability of bankruptcy (10 marks)

- b) Explain five factors that may result in corporate failure (10 marks)

QUESTION THREE

- a) Explain what convertible securities are and how they relate to complex capital structure for organizations. (8 marks)

b) Information relating to the complex capital structure of Rinehart Corporation is as follows:

2020 net income: kshs. 50,000, 2021 income tax rate: 20% , Common stock: 10,000 shares outstanding

Shs.100 par convertible preferred stock: 1,000 shares with each share of preferred stock convertible into two shares of common stock

9% convertible bonds: shs.100,000 face value (issued at par), each shs.1,000 bond convertible into 30 shares of common stock

10% convertible bonds: shs. 50,000 face value (issued at par), each shs. 1,000 bond convertible into 30 shares of common stock

2021 preferred dividends: shs. 3.00 per share

All stocks and bonds have been outstanding for the entire year

(a) Prepare a ranking of the order in which the securities would be included in diluted EPS. (5marks)

(b) Compute basic earnings per share. (3 marks)

(c) Compute diluted earnings per share. (4 marks)

QUESTION FOUR

a) Evaluate the usefulness of financial ratio analysis in assessing the financial state of an enterprise using the case below for ABC ltd.

	2018	2019	2020
Sales	<u>480,000</u>	<u>560,000</u>	<u>690,000</u>
Profits before tax	63,000	70,000	74,000
Tax	<u>23,000</u>	<u>50,200</u>	<u>28,000</u>
Profits after tax	40,000	45,000	46,000
Dividends	<u>30,000</u>	<u>30,000</u>	<u>36,000</u>
Retained profit for year	<u>10,000</u>	<u>15,000</u>	<u>10,000</u>

Share capital (600000),

Shs. 0.25 per share	150,000	150,000	150,000
Retained profit	<u>85,000</u>	<u>100,000</u>	<u>110,000</u>
Shareholder funds	235,000	250,000	260,000
10% debenture	<u>65,000</u>	<u>150,000</u>	<u>150,000</u>
Capital employed	<u>300,000</u>	<u>400,000</u>	<u>410,000</u>

Market price per share 1.00

1.50

Debt interest 6,500

15,000

Required:

Compute and comment on:

- Return on Equity (3marks)
- Asset turnover (3marks)
- Debt to Equity ratio (3 marks)
- Net profit margin (3 marks)
- Interest coverage ratio (3 marks)

b) Explain four limitations of using financial ratio to make decisions (8 marks)