KENYATTA UNIVERSITY

UNIVERSITY EXAMINATIONS 2017/2018

FIRST SEMESTER EXAMINATION FOR THE DEGREE OF MASTER OF SCIENCE (FINANCE) AND MASTER OF BUSINESS ADMINISTRATION

BAC 819: FINANCIAL ANALYSIS

DATE: Monday, 20th November 2017 **TIME:** 2.00 p.m. - 5.00 p.m.

INSTRUCTIONS:

Answer all the questions in the separate booklet provided.

Clearly show all your workings in the booklet.

QUESTION ONE

Onslow Ltd is a company quoted on the stock exchange. An investor was alarmed when Onslow Ltd. dropped its year 2016 dividend to Sh.3.00 per share from Sh.4.00 per share which it had paid in the previous two years.

The investor has approached you for advice and you have gathered the information given below regarding the financial condition of Onslow Ltd. and the finance sector as a whole.

Onslow Ltd. statement of financial position as at 31 October

	2014 Sh.'000'	2015 Sh.'000'	2016 Sh.'000'
Cash	30500	28800	16000
Accounts receivable	160640	175600	268800
Inventory	1 97200	317600	508000
Total current assets	388340	522000	792800
Land and buildings	50460	55200	50000
Machinery	67600	72800	61200
Other fixed assets	29840	37400	32800
Total assets	536240	687400	826800
Accounts and notes payable	68440	147520	271696
Accruals	31400	68000	134000
Total current liabilities	99840	215520	405696
Long term debt	121700	121716	163440
Ordinary share capital	230000	230000	230000
Retained earnings	84700	120164	137664
	536240	687400	936800

*INVOLVEMENT IN ANY **EXAMINATION IRREGULARITY** SHALL LEAD TO **DISCONTINUATION***

ABC Ltd. Income Statements for the year ending 31 October

	2014 Sh.'000'	2015 Sh.'000'	2016 Sh.'000'
Sales (all on credit)	1654000	1716000	1780000
Cost of sales	(1323200)	(1420000)	(1424000)
Gross profit	330800	296000	356000
General administrative and selling expenses	(127200)	(94528)	(102400)
Other operating expenses	(50800)	(63600)	(76400)
Earnings before interest and taxes	152800	137872	177200
Interest expense	(51200)	(53600)	(63,600)
Net income before taxes	63,600	84272	113600
Taxes	(50800)	(33708)	(20,000)
Net income	**101600**	**50564**	**93600**
Number of shares issued	9200,000	9200,000	9200,000
Per share data:			
Earnings per share (EPS)	Sh. 16.60	Sh. 11.1	Sh. 6.52
Dividend per share	Sh. 4.00	Sh. 4.00	Sh. 3.00
Market price (average)	Sh.97.8	Sh.51.00	Sh.26.50

	Industry Ratios 2008)	**Financial**
Quick ratio	1.0	
Current ratio	2.5	
Inventory turnover	7 times	
Average collection period	30 days	
Fixed asset turnover	12.0 times	
Total assets turnover	2.7 times	
Net income to net worth	1.75%	
Net profit margin on sales	37.5%	
Price-Earnings (P/E) ratio	7times	
Debt/Equity ratio	50%	

Notes:

1. Industry ratios have been roughly constant for the past four years.
2. Inventory turnover, total assets turnover and fixed assets turnover are based on the year-end balance sheet figures.

Required:

(a) The financial ratios for ABC Ltd for the past three years corresponding to industry ratios given above. **(5 marks)**

(b) Comment the strengths and weaknesses revealed by these ratios based on:
  (i) Trends in the firm's ratios **(5marks)**
  (ii) Comparison with industry averages. **(5 marks)**
  (The summary should focus on the liquidity, profitability and turnover ratios).

(c) Perform a dupont analysis for the two years and comment on the results on the basis of margins, and efficiency **(5 marks)**

(Total: 20 marks)

QUESTION TWO

a. Discuss the role of cash budgeting in an organisation **(5 marks)**

b. Abinto ltd is preparing for the month of April and May.the following information is available.

1. The firm makes 20 per cent cash sales. Credit sales are collected 40, 30 and 25 per cent in the month of sales, month after and second month after sales, respectively. The remaining 5 per cent becomes bad debts.
2. The firm has a policy of buying enough goods each month to maintain its inventory at two and one-half times the following month's budgeted sales.
3. The firm is entitled to 2 per cent discount on all its purchases if bills are paid within 15 days and the firm avails of all such discounts. Monthly purchases are made in two equal lots on fortnightly basis.
4. Cost of goods sold, without considering the 2 per cent discount, is 50 per cent of selling prices. The firm records inventory net of discount.
5. Other data is:

	Sales shs
January (actual)	1000000
February (actual)	1200000
March (actual)	1500000
April (budgeted)	1700000
May (budgeted)	1400000

- Inventory on March 31, sh 2254000.
- Cash on March 31, sh 300000.
- Gross purchases in March, sh 1,000,000.
- Selling, general and administrative expenses budgeted for April, sh 450,000 (includes sh 100,000 depreciation).

Required

From the above information, prepare cash budget of the firm for the month of April. **(10 marks)**

(Total: 15 marks)

QUESTION THREE

Mansfield Corporation had 2016 sales of sh100 million. The balance sheet items that vary directly with sales and the profit margin are as follows:

Percent

Cash.. 5%
Accounts receivable.. 15
Inventory.. 20
Net fixed assets 40
Accounts payable 15
Accruals 10
Profit margin after taxes...................................... 10%

The dividend payout rate is 50 percent of earnings, and the balance in retained earnings at the end of 2016 was sh33 million. Notes payable are currently sh7 million. Long-term bonds and common stock are constant at hsh5 million and sh10 million, respectively.

i. How much additional external capital will be required for next year (2017)if sales increase 15 percent? (Assume that the company is already operating at full capacity.) **(8 marks)**

ii. What will happen to external fund requirements if Mansfield Corporation reduces the payout ratio. **(2 marks)**

iii. Prepare a pro forma balance sheet for 2017 assuming that any external funds being acquired will be in the form of notes payable. Disregard the information in part *ii* in answering this question (that is, use the original information and part *i.* in constructing your pro forma statement of financial position). **(5 marks)**

(Total: 15 marks)

QUESTION FOUR

Describe the *five* component analyses that constitute business analysis **(5marks)**

Discuss the limitations of Altman Z score of predicting bankruptcy. **(3 marks)**

In the context of equity analysis, distinguish between fundamental analysis and technical analysis **(2 marks)**

(Total: 10 marks)