

CHUKA



UNIVERSITY

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

BCOM 334: FINANCIAL STATEMENT ANALYSIS

STREAMS: BCOM (Y3S1)

TIME: 2 HOURS

DAY/DATE: MONDAY 02/12/2019

11.30 A.M. – 1.30 P.M.

INSTRUCTIONS: Answer question ONE and any other TWO questions

QUESTION ONE (30 MARKS)

- (a) What information is contained in the following sources, other than financial statement?
- (i) Proxy statements [2 marks]
 - (ii) Auditors report [2 marks]
 - (iii) Management's discussion & analysis [2 marks]
 - (iv) Footnotes [2 marks]
- (b) ABC Ltd ended 2018 with a net profit before tax of ksh. 218, 000. The company is subject to a corporate tax of 40% and must pay ksh. 32,000 in preferred stock dividends before distributing any earnings to the 85,000 ordinary shares currently outstanding. Calculate the EPS and retained earnings for the firm assuming that ordinary dividend paid was ksh. 0.85 per share. [6 marks]
- (c) The management of Deacons Holdings Ltd provides you with comparative income statements for the years ended December 31, 2017 and 2016

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Deacons holding ltd

Income statements

For the year ended 31st December (sh. 000)

	2017 (sh '000)	2016 (sh '000)
Sales revenue	3800	2600
Less: cost of sales	(1800)	(1700)
Gross profit	2000	900
Less: operating expenses	(560)	(500)
Operating profit	1440	400
Less: interest expense	(100)	(90)
Net profit before taxes	1340	310
Less: taxes (30%)	(402)	(93)
Net profit after tax	938	217
Less: preferred dividends	(10)	(10)
Earnings available to ordinary shareholders	838	207

Deacons holdings ltd Statement of financial position As at 31st December (sh. 000)

	2017	2016
Current Assets	1270	1000
Net non-current assets	2400	2200
Total assets	3670	3200
Liabilities & stockholders' equity:		
Total current liabilities	600	500
Long term debt	1000	900
Total liabilities	1600	1400
Shareholders' equity:		
5% preferred stock (sh. 100 par)	200	200
Ordinary shares (sh. 2.50 par)	250	200
Share premium	420	400
Retained earnings	1200	1000
Total liabilities & stockholders' equity	3670	3200

The end of year market price per ordinary share of Deacons Holding Ltd was sh. 25.25 and sh 32.25 in 2016 and 2017 respectively

Your comparative analysis of the two years requires using the ratios reported. You identify five key ratios of comparison in your analysis:

- (i) Current ratio
- (ii) Earnings Per Share (EPS)
- (iii) Price/Earnings ratio

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- (iv) Debt ratio
- (v) Average collection period

Required:

Discuss the differences between 2017 and 2016 in each of these ratios [15 marks]

QUESTION TWO

- (a) Explain the following components of business analysis
 - (i) Business environment and strategy analysis [4 marks]
 - (ii) Credit analysis [4 marks]

- (b) You are provided with the following information relating to Home-Africa ltd for the year ended 31st December 2018

	Kshs
Preference dividends	61,000
Profit before tax	376,000
Sales	3,074,000
Current assets	1,223,000
Net Fixed Assets	2,374,000
Financial leverage multiplier	2.06
Tax rate	25%

Required:

- (i) Calculate earnings available to ordinary shareholders [6 marks]
- Use Dupont system of analysis to determine
- (ii) The Net Profit Margin [2 marks]
 - (iii) Return on Total Assets [2 marks]
 - (iv) Total Assets turnover [2 marks]

QUESTION THREE

- (a) Briefly explain the parties interested in analysis of financial statements and why they are interested in the analysis [12 marks]
- (b) The following are extracts from the statement of financial position of Owen Ltd as at 31st December 2013

Total liabilities	150,000
5% preference share capital (2000, sh. 100 par): Authorized and issued	20,000
Ordinary share capital (100,000 sh. 2.5 par): Authorized and issued	250,000
Share premium on ordinary shares	50,000
Retained earnings	80,000
The market price per ordinary share at the close of the year	Sh. 5.32

Required: calculate and interpret the market to book ratio for the firm [8 marks]

QUESTION FOUR

- (a) What is the significance of a cash flow statement to a financial analyst? [6 marks]
- (b) What problems might a financial analyst encounter in comparing performance of companies on the basis of their ratios? [4 marks]
- (c) Selected comparative income statements for SIB Company are given below:

Year	2016	2015
Net sales	990,000	810,000
Cost of goods sold	574,000	461,700
Gross profit	416,000	348,300
Operating expenses		
Selling expenses	130,000	132,000
General expenses	122,500	125,500
Total operating expenses	252,500	257,500
Income from operations	163,500	90,800
Interest expense	24,000	24,000
Income before tax	139,500	66,800
Income tax expense	36,360	17,368
Net income	103,140	49,432

Required: prepare common size income statements for the company and analyze from managerial perspective, changes in gross margin and net income to sales ratio across the periods. [10 marks]