



**STRATHMORE BUSINESS SCHOOL**  
**BACHELOR OF FINANCIAL SERVICES**  
**END OF SEMESTER EXAMINATION**  
**BNK 4102: CREDIT RISK ANALYSIS AND MANAGEMENT**

**DATE:** Mon, 29<sup>th</sup> July 2024

**TIME:** 10:30 – 12:30

**Instructions**

1. This examination consists of **FIVE** questions.
2. Answer **Question ONE (COMPULSORY)** and any other **TWO** questions.

**QUESTION ONE**

**(30 Marks)**

- a) Credit analysis must be separated into two functions; investigation and verification. Distinguish between the two. **(4 Marks)**
- b) Off-balance sheet items may be overlooked by lenders in their performance of due diligence, but these items are particularly important in determining the ultimate assessment of risk between the parties. Explain **five** considerations which should be taken into account in an assessment of off-balance sheet items. **(5 Marks)**
- c) Management projections are an important indicator of what management believes the future business prospects would be. However, projections must be reviewed critically as borrowers may present a brighter picture than is warranted or reasonable under the circumstances. As a credit analyst, list **six** questions that you would ask about the projections presented to you. **(6 Marks)**
- d) Explain any **five** dimensions (indicators) that can be used in performing a client's competitiveness analysis. **(5 Marks)**
- e) The following data relates to a loan applicant; a company in the telecommunications industry for the year to 31 December 2023:

Item	Sh. 000
Sales	30 000
Total assets	25 678
Retained earnings	177
Total liabilities	15 600
Working capital	1 777
Earnings before interest and tax	2 605
Market value of equity	10 098
Book value of long-term debt	5 044

**Required:**

Using the Altman's Z-score model assess the financial health of the company and advise on the loan eligibility.

**(6 Marks)**

- f) Explain **four** benefits of loan sales and securitization to a financial institution. **(4 Marks)**

**QUESTION TWO****(20 Marks)**

- a) As a credit analyst explain the relevant information that you will be interested in when reviewing the accounts receivable of a loan applicant. **(6 Marks)**

- b) Faida Bank Ltd has created a sequential pay collateralized mortgage obligations (CMOs) with a total pool value of Sh. 150 million and three classes, A, B and C with principal amounts of Sh. 50 million per class. The mortgages in the pool have a 9% interest rate per annum and the CMO makes monthly payments. Assume that the mortgage holders made their scheduled monthly payments in the first two months. In the first two months; the amount paid into the pool was Sh. 2 million and Sh. 3 million respectively.

**Required:**

Show how the payments will be settled and comment about pre-payment risk. **(8 Marks)**

- c) Explain the non-performing loans classification criteria in line with the IFRS 9. **(6 Marks)**

**QUESTION THREE****(20 Marks)**

- a) The following are financial statements of Beta Ltd:

Beta Ltd  
Statement of Financial Position  
As at Dec 31,2023

	2023 Shs	2022 Shs
<b>Assets:</b>		
Cash	95 800	25 000
Accounts receivable (net)	42 000	52 000
Inventory	86 800	96 800
Prepaid expenses	6 400	5 200
furniture	110 000	120 000
Accumulated depreciation - Furniture	(18 000)	( 10 000)
<b>Total assets</b>	<b><u>323 000</u></b>	<b><u>289 000</u></b>
<b>Liabilities and equity:</b>		
Accounts payable	16 000	22 000
Wages payable	10 000	6 000
Income taxes payable	2 400	3 600
Notes payable[long-term]	30 000	70 000
Ord. Shares @ Sh 5.00 par value	230 000	180 000
Retained earnings	<u>34 600</u>	<u>7 400</u>
	<b><u>323 000</u></b>	<b><u>289 000</u></b>

**Beta Ltd**  
**Income Statement**  
**For the period ended December 31,2023**

Sales		468,000
Cost of goods sold		<u>312,000</u>
Gross profit		156,000
Operating expenses:		
Depreciation expenses	8 000	
Other expenses	<u>17,000</u>	
		<u>25,000</u>
Income before taxes		131,000
Income taxes		<u>24,600</u>
Net income		<u>106,400</u>

Cash dividends amounting to Ksh 29 600 was paid during the period.

**Required:**

- i. Prepare Statement of cash flows using the indirect method **(10 Marks)**
  - ii. Comment about Beta Ltd's current liquidity position and future growth prospects taking into account the operating, investing and financing cashflows **(4 Marks)**
- b) Credit rating can be used as a tool for credit analysis.

**Required:**

- i. Distinguish credit rating from credit reporting **(2 Marks)**
- ii. Explain meaning of the following
 

Sovereign credit rating	<b>(1 Mark)</b>
Investment grade	<b>(1 Mark)</b>
Junk bond	<b>(1 Mark)</b>
Prime bond	<b>(1 Mark)</b>

**QUESTION FOUR** **(20 Marks)**

- a) Identify the **four** parties involved in loan syndication process and explain their respective roles **(6 Marks)**
- b) Distinguish the following letters of credit **(4 Marks)**
  - i. Confirmed Letter of Credit
  - ii. Standby Letter of Credit
  - iii. Revolving Letter of Credit
  - iv. Red Clause Letter of Credit
- c) Explain the role of the board of directors in bank's credit risk management **(6 Marks)**
- d) List the eight pieces of information that should be contained in the credit files of financial institutions as per the CBK regulations **(4 Marks)**

**QUESTION FIVE****(20 Marks)**

- a) A.B. Ltd had the following capital structure on 31<sup>st</sup> December, 2023

	Sh.
100 000 ordinary shares, Sh 1 each	100 000
50 000, 8% preference shares, Sh 1 each	<u>50 000</u>
	<u>150 000</u>

The market price of ordinary shares on 31<sup>st</sup> December was Sh 3.00. Declared dividend was 10%. In the year, the total earnings were Sh 68 000 and the tax rate was 50%. You are required to calculate

- i. Dividend yield **(2 Marks)**
  - ii. Earnings per share **(2 Marks)**
  - iii. Price–Earnings ratio **(2 Marks)**
- b) The following are the financial statements of Hamaya Ltd. For the year ended 31st December, 2023.

Statement of Financial Position as at 31st December, 2023:

	Sh000		Sh000
Cash	1 400 000	Accounts payable	950 000
Accounts receivable	780 000	Short-term notes payable	1 300 000
Inventories	2 100 000	Long-term loan	1 900 000
Land	1 200 000	Bank-overdraft	50 000
Plant and equipment	1 600 000	Debentures	1 000 000
Vehicles	<u>1 000 000</u>	Shareholder's equity	<u>1 620 000</u>
	<u>6 820 000</u>		<u>6 820 000</u>

Income Statement for the year ended 31st December, 2023

	Sh. 000	Sh.000
Sales		8,000,000
Less: Cost of sales		<u>4,500,000</u>
Gross profit		3,500,000
Deduct: Selling expenses	800,000	
Administrative & gen. Expenses	1,200,000	
Interest charges	<u>560,000</u>	<u>2,560,000</u>
Profit before taxation		940,000
Taxation		<u>282,000</u>
Net profit		<u>658,000</u>

**Required:**

Calculate the following ratios for Hamaya Ltd **(8 Marks)**

- i. Current ratio
- ii. Acid test ratio
- iii. Stock turnover ratio
- iv. Total assets turnover ratio
- v. Times interest earned ratio
- vi. Net profit margin
- vii. Return on investment
- viii. Return on shareholders'

- c) Explain **six** limitations of ratio analysis as a tool for credit risk analysis **(6 Marks)**