



Strathmore
UNIVERSITY

STRATHMORE INSTITUTE OF MATHEMATICAL SCIENCES
BBS FINANCIAL ENGINEERING AND FINANCIAL ECONOMICS
END OF SEMESTER EXAMINATION
BSF 3213: FINANCIAL ANALYSIS AND MODELLING

DATE: 2nd December 2024

Time: 2 Hours

Instructions

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

Question One

Section A

- a) Giving relevant examples, explain briefly how the accounting ratios can help the company determine its strategic and competitive capabilities. **(6 marks)**
- b) Explain briefly two indicators of possible business failure discussing its relevant in financial analysis. **(4 marks)**

(Total: 10 marks)

Section B

- a) The books of Eastham Co show the following:

	Shs. '000'
Loss before interest and tax	5,000
Depreciation	23,000
Income from associate	6,000
Tax paid	10,000

What is Eastham Co's net cash inflow from operating activities?

(4 marks)

- b) The books of Quest Co include the following figures, extracted from the financial statements for the year ended 31 December 2024.

Statement of Profit or Loss

	Shs
Gross profit	83,250
Interest expense	9,465
Tax expense	6,270
Profit for the year	17,600

Statement of Financial Position

	Shs
Equity	127,920
Non-current liabilities	63,200
Current liabilities	57,960

What is Quest Co's return on capital employed at 31 December 2024? **(4 marks)**

c) The draft accounts of Swan Co for the year ended 31 December 2024 include the following:

Revenue Shs.240m

Gross profit Shs.60m

It was subsequently discovered that the revenue was overstated by Shs.30m and the closing inventory understated by Shs.10m.

What will the gross profit percentage be after the correction of the above errors? **(4 marks)**

d) Mary, who has just completed her first finance course, is unsure whether he should take a course in business analysis and valuation using financial statements, since he believes that financial analysis adds little value, given the efficiency of capital markets. Explain to Mary when financial analysis can add value, even if capital markets are efficient. **(4 marks)**

e) Without financial information that is complete and accurate can pose a challenge to financial analysis. Credibility in financial information enhances decision-making enabling the financial analyst in providing appropriate and sufficient recommendations.

Requirement:

Audited financial statements do not provide a guarantee that the financial information is complete and accurate, and the financial analyst should be aware of this; Discuss. **(4 marks)**

(Total: 20 marks)

Question Two

a) Explain the importance of analyzing the cash flow statement? **(4 marks)**

b) The following is an extract of the financial statements of InfoTech Limited for the years 2024 and 2025:

InfoTech Limited		
Statement of financial position as at 30 th June		
	2024	2025
	Shs'000'	Shs'000'
Non-current Assets	<u>72,500</u>	<u>75,000</u>
Current Assets:		
Inventory	24,500	26,500
Receivables	34,000	36,500
Cash at Bank	<u>1,250</u>	<u>2,250</u>
	<u>59,750</u>	<u>65,250</u>
	<u>132,250</u>	<u>140,250</u>
Capital and Reserves:		
Issued Share Capital	50,000	50,050
Reserves	26,100	32,600
Non-current liabilities:		
10% Loan Notes	20,000	21,500
Current Liabilities:		
Trade payables	31,900	31,000
Taxation	2,250	2,950
Dividend	<u>2,000</u>	<u>2,150</u>
	<u>132,250</u>	<u>140,250</u>

InfoTech Limited
Statement of comprehensive income for the year ended 30th June 2025

	Ksh '000
Sales Revenue	195,000
Profit from Operations	13,750
Net Interest Cost	(2,150)
Profit before Taxation	11,600
Income Tax Expense	(2,950)
Profit after Tax	8,650
Dividends	(2,150)
Net Profit for Period	6,500

Additional information:

Depreciation charge for the year is Kshs 6,000,000. Non-current assets which were disposed in year at Kshs 300,000 had an accumulated depreciation of Kshs. 175,000 and had a cost of Kshs 500,000.

Requirement:

- i) A statement of cash flows for the year ended 30th June 2025. **(8 marks)**
- ii) An analysis of profitability and risk of the entity. **(8 marks)**

(Total: 20 marks)

Question Three

- a) Explain what is meant by the term 'Earnings management' **(2 marks)**
- b) Potential lenders to a firm, whether short- or long-term, assess the likelihood that the firm will pay periodic interest and repay the principal amount lent.
Required:
Discuss the 5Cs in evaluation of credit risk of a borrower. **(6 marks)**
- c) According to IASs 33 (*Earnings Per Share*), explain why the diluted earnings per share is more suitable for valuation purposes than the basic EPS. **(4 marks)**
- d) Jambo Ltd reported Shs. 1,000,000 in net income for the year ending 30 June 2023 on weighted average common shares outstanding of 400,000. Jambo Ltd has Shs. 4,000,000 face value of convertible bonds outstanding with an annual coupon rate of 10%. The bonds were issued on 1 July 2022 and can be converted into common shares at a conversion ratio of 50 shares per 1,000 of face value. Jambo Ltd has also had 500,000 outstanding warrants with an exercise price of Sh. 40 that were issued on 30 June 2022. The average share price during the year was Shs. 50, and the marginal tax rate is 30%.

Required:

Compute the basic and the diluted earnings per share. **(8 marks)**

(Total: 20 marks)

Question Four

You are provided with the following extracts of financial statements of Success company limited

SUCCESS CO. LTD	
STATEMENT OF PROFIT OR LOSS	
FOR THE YEAR ENDING 30 JUNE 2023	
	Shs'm'
Revenue	124.90
Cost of sales (including depreciation at Shs. 21.4m)	(114.60)
Gross profit	10.30
Operating expenses	(0.50)
Profit for the period.	9.80

SUCCESS CO. LTD		
STATEMENT OF FINANCIAL POSITION		
AS AT 30 JUNE		
	2023	2022
	Shs'm'	Shs'm'
PPE	74.40	69.90
Equity and Liabilities		
Equity		
Shareholders' funds	66.70	62.20
Non-Current Liabilities	7.70	7.70
Total Equity and Liabilities	74.40	69.90

Required:

Determine the valuation of the equity and the enterprise after projected statement of cash flows.

(Total: 20 marks)

Question Five

- (a) Financial statement analysis is the process of gathering the financial data of a company from the various sources, analyzing the data, interpreting the data and providing recommendation which assist in investment decision of the company under study.

Requirement:

- (i) Describe the roles of financial reporting and financial statement analysis. **(3 marks)**
- (ii) Describe the importance of financial statement notes and supplementary information including disclosures of accounting policies, methods, and estimates and management's commentary. **(4 marks)**
- (iii) Identify and describe information sources that analysts use in financial statement analysis besides annual financial statements and supplementary information. **(3 marks)**

- b) The financial markets are vast and complex, not only in Kenya, but also the global markets. Choices are endless on where to invest, including investments in stocks, bonds, real estate, hedged funds, commodities, mutual funds, derivatives, options among other investments. Everyone wants to make the best investment decisions and create value for his/her investment. Yet, throughout the past years we have faced tremendous market swings, rendering investors (and their money) in a sea of lost hopes and few investors with a plethora of wealth. Many of these market anomalies and swings are dependent, and in a sense dictated by the investors. The investor plays a part in setting the current stock price. The reaction of the investor can aid in determining the success of an initial public offering (IPO). The collective psychology of the market as a whole plays a major role, but if the everyday investor were better equipped with the proper tools to understand the underlying fundamentals of a rational investment, smarter investment decisions could be made, more rational investments would be made, and the markets would be a more efficient environment.

Requirement:

- i) Discuss the benefits of financial statement analysis and valuations. **(5 marks)**
- ii) How are business analysis and financial statement analysis connected. **(5 marks)**