PIONEER INTERNATIONAL UNIVERSITY

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UNIVERSITY EXAMINATIONS

ACADEMIC YEAR: 2021/2022 **UNIT NAME:** FINANCIAL STATEMENT ANALYSIS

SEMESTER: SEP-DEC 2021 **UNIT CODE:** FNCE 3112

DATE: DEC 2021 **TIME:** 2 HOURS

Instructions: Answer SECTION A (Compulsory) and Any Other Two Questions

SECTION A 30 MARKS

(a) The following is an extract from the financial statement of Kenyango Ltd.

	Shs '000'
Issued Share Capital	
150,000 ordinary shares of Shs.10 each	1,500,000
10% loan stock 1999	2,000,000
Share premium	1,500,000
Revenue Reserve	7,000,000
Capital employed	12,000,000

(i) The profits after tax (30%) is Shs.600,000. However interest charge has not been deducted.

(ii) Ordinary dividend payout ratio is 40%

(iii) The current market value of ordinary shares is Shs.36

REQUIRED:

1) Return on capital employed (3 marks)

(2) Earning per share (2 marks)

(3) Price earning ratio (2 marks)

(4) Book value per share (2 marks)

(5) Gearing ratio (2 marks)

(6) Market to took value per share (2 marks)

(b) Discuss any five limitations of using ratio analysis in financial statement analysis. (10 marks)

(c) Discuss any three limitations of Financial Statement Analysis. (6 marks)

Section B Answer any Two Questions

Question 2 [20 marks]

a. Huff Company and Mesa Company are similar firms that operate in the same industry. The following information is available:

	HUFF			MESA		
	2006	2005	2004	2006	2005	2004
Current ratio	1.6	1.7	2.0	3.1	2.6	1.8
Acid test ratio	0.9	1.0	1.1	2.7	2.4	1.5
Accounts receivable T.O	29.5	24.2	28.2	15.4	14.2	15.0
Inventory T.O	23.2	20.9	16.1	13.5	12.0	11.6
Working capital	60,000	48,000	42,000	121,000	93,000	68,000

Write a one-half page report comparing Huff and Mesa using the available information. Your discussion should include their ability to meet current obligations and to use current assets efficiently. [12 marks]

b. On January 1, Year 1, you are considering the purchase of Nico Enterprises' common stock. based on your analysis of Nico Enterprises, you determine the following:

1. Book value at January 1, Year 1, is $50 per share.

2. Predicted net income per share for Year 1 through Year 5 is $8, $11, $20, $40, and $30, respectively.

3. For Year 6 and continuing for all years after, predicted residual income is $0.

4. Nico is not expected to pay dividends.

5. Required rate of return (cost of capital) is 20%.

Required:

Determine the purchase price per share of Nico Enterprises' common stock as of January 1, Year 1, using the residual income valuation model (round your answer to the nearest cent). Comment on the strengths and limitations of this model for investment decisions. [8 marks]

Question Three

Ace Co. is to be taken over by Beta Ltd. at the end of year 2007. Beta agrees to pay the shareholders of Ace the book value per share at the time of the takeover. A reliable analyst makes the following projections for Ace (assume cost of capital is 10% per annum):

$ per share	2002	2003	2004	2005	2006	2007
Dividends	-	$1.00	$1.00	$1.00	$1.00	$1.00
Operating cash flow	-	2.00	1.50	1.00	0.75	0.50
Capital expenditure	-	-	-	1.00	1.00	-
Debt Increase(decrease)	-	(1.00)	(0.50)	1.00	1.25	0.50
Net income	-	1.45	1.10	0.60	0.25	(0.10)
Book Value	9.00	9.45	9.55	9.15	8.40	7.30

CHECK Value using RI, $8.32

Required

a. Estimate Ace Co.'s value per share at the end of year 2002 using the dividend discount model.
[7 marks]

b. Estimate Ace Co.'s value per share at the end of year 2002 using the residual income model.

[7 marks]

c. Attempt to estimate the value of Ace Co. at the end of year 2002 using the free cash flow to equity model.
[6 marks]

Question Four

As controller of Tallman Company, you are responsible for keeping the board of directors informed about the company's financial activities. At the recent board meeting, you presented the following financial data:

	2006	2005	2004
Sales trend percent	147%	135%	100%
Selling expenses to net sales	10.1%	14%	15.6%
Sales to plant assets	3.8 to 1	3.6 to 1	3.3 to 1
Current ratio	2.9 to 1	2.7 to 1	2.4 to 1
Acid test ratio	1.1 to 1	1.4 to 1	1.5 to 1
Merchandise inventory T.O	7.8 times	9.0 times	10.2 times
Accounts receivable turnover	7.0 times	7.7 times	8.5 times
Total Asset turnover	2.9 times	2.9 times	3.3 times
Return on total assets	9.1%	9.7%	10.4%

Return on stockholders' equity	9.75%	11.50%	12.25%
Profit margin	3.6%	3.8%	4.0 %

After the meeting, the company's CEO held a press conference with analysts in which she mentions the following ratios:

	2006	2005	2004
Sales trend percent	147%	135%	100%
Selling expenses to net sales	10.1%	14%	15.6%
Sales to plant assets	3.8 to 1	3.6 to 1	3.3 to 1
Current ratio	2.9 to 1	2.7 to 1	2.4 to 1

Required:

a. Why do you think the CEO decided to report these 4 ratios instead of the 11 ratios that you prepared? [10 marks]

b. Comment on the possible consequences of the CEO's reporting decision. [10 marks]

IMPORTANT NOTICE !!!!!!!!!!!!

The following are the possible consequences if found guilty of an Examination Offence:

a) Expulsion from the University.

b) Academic Leave.