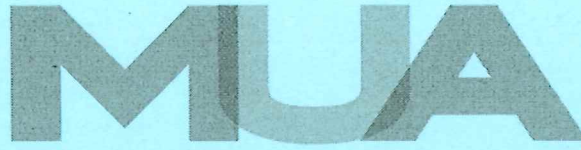


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**UNDERGRADUATE UNIVERSITY EXAMINATIONS**  
**SCHOOL OF MANAGEMENT AND LEADERSHIP**  
**DEGREE OF BACHELOR OF COMMERCE**

**FIN 424: FINANCIAL ANALYSIS AND VALUATION**

**DATE: 3<sup>RD</sup> DECEMBER 2024**

**DURATION: 2 HOURS**

**MAXIMUM MARKS: 70**

**INSTRUCTIONS:**

1. Write your registration number on the answer booklet.
2. **DO NOT** write on this question paper.
3. This paper contains **SIX (6)** questions.
4. Question **ONE** is compulsory.
5. Answer any other **THREE** questions.
6. Question **ONE** carries **25 MARKS** and the rest carry **15 MARKS** each.
7. Write all your answers in the Examination answer booklet provided.

**QUESTION ONE**

Read the Case Study below carefully and answer the questions that follow:

**Indicators of a Financially Distressed Firm**

XYZ Manufacturing Co. is a mid-sized company specializing in producing industrial machinery. Over the past two years, the company has faced significant financial challenges due to increased competition, rising raw material costs, and declining sales. Some of the financial challenges include: declining revenues over the past two years, increasing debt levels and interest expenses, deteriorating profit margins, negative operating cash flow, decrease in current ratio and quick ratio and frequent delays in paying suppliers and creditors. The management team is concerned about the company's financial health and is seeking to identify the indicators of financial distress.

The company has been having the following financial issues:

- Current Ratio: Declined from 1.5 to 1.0 over the past two years.
- Quick Ratio: Dropped from 1.2 to 0.8 in the same period.
- Negative operating cash flow for six consecutive quarters.
- Debt-to-Equity Ratio: Increased from 1.0 to 2.5.
- Debt-to-Assets Ratio: Rose from 0.4 to 0.7.
- Gross Profit Margin: Decreased from 35% to 25%.
- Operating Profit Margin: Fell from 15% to 5%.
- Net Profit Margin: Declined from 10% to 2%.
- Accounts Receivable Turnover: Decreased from 8 times to 5 times per year.
- Inventory Turnover: Dropped from 6 times to 4 times per year.
- Suppliers and creditors report delayed payments and requests for extended credit terms.

**Required:**

- a) Explain to the management of XYZ Manufacturing Co. five key indicators of a financially distressed firm **(10 marks)**
- b) Based on the financial information provided in the case study, analyze three indicators that suggest that XYZ Manufacturing Co. is in financial distress

**(6 marks)**

- c) Propose three strategies that the management of XYZ Manufacturing Co. can use to address its financial distress and improve its financial health (6 marks)
- d) Assess the role that corporate governance plays in preventing financial distress, and how XYZ Ltd can improve its governance practices (3 marks)

## QUESTION TWO

- a) As much as public listed companies are expected to timely release all information about their company to the interested parties, there are some additional costs associated with this. Examine four costs of disclosure of financial information (8 marks)
- b) A 4-year corporate bond is issued with a 12% coupon rate at a \$5,000 face value. It has a yield to maturity of 10%. According to the bond indenture, coupon payments are payable annually to the investor.

### Required:

- i. Determine the Present Value of Single Cashflow from future coupon payments (3 marks)
- ii. Determine the total cashflow from coupon payments (4 marks)

## QUESTION THREE

- a) Propose the steps an analyst would follow to conduct financial statement analysis (5 marks)
- b) The data below relates to ABC Ltd's Income Statement and Balance Sheet;

### Profit or Loss and Other Comprehensive Income Data (in \$ millions):

- Total Sales: \$200 million
- Cost of Goods Sold (COGS): \$120 million
- Gross Profit: \$80 million
- Operating Expenses: \$40 million
- Net Income: \$20 million
- Common Size Income Statement:

**Statement of Financial Position Data (in \$ millions):**

- Total Assets: \$500 million
- Cash: \$50 million
- Inventory: \$150 million
- Property, Plant, and Equipment (PP&E): \$200 million
- Total Liabilities: \$300 million
- Total Equity: \$200 million

**Required:**

Prepare a common size income statement and balance sheet analysis (10 Marks)

**QUESTION FOUR**

a) XYZ Manufacturing Co. is planning its cash budget for the upcoming quarter. The company produces and sells widgets, and management needs to ensure that it has sufficient cash flow to meet its obligations and avoid liquidity problems. The following information has also been provided:

- Sales are projected to be \$200,000 in January, \$250,000 in February, and \$300,000 in March.
- 60% of sales are collected in the month of sale, 30% in the following month, and 10% in the second month after the sale.
- Purchases are \$100,000 in January, \$120,000 in February, and \$150,000 in March. Purchases are paid 50% in the month of purchase and 50% in the following month.
- Other expenses are \$30,000 per month.
- The opening cash balance on January 1st is \$20,000.
- The company aims to maintain a minimum cash balance of \$10,000.
- No capital expenditures or loan payments are expected during this period.

**Required:**

Prepare a cash budget for the 1<sup>st</sup> quarter using the receipts and payments method (9 marks)

b) Discuss three reasons why financial forecasting is important (6 marks)

**QUESTION FIVE**

a) Company A has provided you with the following information:

Total assets are worth \$3,500,000

Working capital of \$4,200,000.

Liabilities stand at \$5,000,000

Retained earnings amount to \$800,000.

Earnings Before Interest and Tax come to \$6,500,000.

Sales total \$8,300,000 while the market value of equity is \$7,000,000.

**Required**

Calculate the Altman's Z score and advise Company A (7 marks)

b) Briefly discuss four other assumptions underlying the percentage of sales method

(8 marks)

**QUESTION SIX**

a) Describe five limitations of the use of ratios as a basis of financial analysis

(5 marks)

b) Examine the need for financial statements to five users

(10 marks)

