



The Co-operative University of Kenya
END OF SEMESTER EXAMINATION AUGUST - 2022
EXAMINATION FOR THE DEGREE BACHELOR OF SCIENCE IN FINANCE
(YR III SEM I)
UNIT CODE: BFIN 3107
UNIT TITLE: EQUITY ANALYSIS AND VALUATION

DATE: 31ST AUGUST, 2022

TIME: 2:30 PM – 4:30 PM

INSTRUCTIONS:

- Answer question **ONE (compulsory)** and any other **TWO** questions

QUESTION ONE

Electric Ltd. is an expanding private company in the electric trade. Accounts prepared on 31st December showed the following information:

Profit Statement for the year ended 31st December (sh.000)

	2019	2020
Sales	2,000	3,200
Less cost of goods sold	<u>1,000</u>	<u>1,800</u>
Gross profit	900	1,400
Less: Trading expenses	<u>450</u>	<u>550</u>
Trading profit	450	850
Less: Debenture interest	<u>25</u>	<u>25</u>
Net profit before taxation	425	825
Less: corporation Tax	<u>160</u>	<u>320</u>
Net profit after taxation	265	505
Less: Ordinary share dividend	<u>125</u>	<u>175</u>
Undistributed profit for year	<u>140</u>	<u>330</u>

Balance Sheet as at 31st December (sh000)

	2019	2020		2019	2020
	sh	sh		sh	Sh
Sources of Capital:			Use of capital:		
Ordinary share			Fixed Assets at cost	1000	1400
Capital authorized & issued (£1 share)	500	500	Less: Depreciation	<u>200</u>	<u>250</u>
	350	680	Current Assets:	800	1150
Undistributed profit	250	110	Stock	400	550
10% Debentures		999	Debtors	250	350
			Cash	<u>80</u>	730
			Less: Current liabilities		
			Creditors	145	200
			Taxation	160	320
			Proposed dividend	<u>125</u>	175
			Bank Overdraft		<u>65</u>
				<u>(430)</u>	<u>(760)</u>
	<u>1100</u>	<u>1290</u>		1100	1290

You are required to:

- i. Calculate six accounting ratios for both 2019 and 2020 which you feel would be of particular value in assessing the profitability and liquidity performance of Electric Ltd. (12marks)
 - ii. Comment on the current position of Electric Ltd. with the aid of the accounting ratios previously selected and any other information that you consider to be relevant. (2marks)
 - iii. Calculate the various shareholders' ratios for decision making purposes as far as stock valuation is concerned (4marks)
- (b) Discuss the disadvantages of Walter dividend models in practice (12marks)

QUESTION TWO (20 MARKS)

- (a) People use the financial system for six main purposes. Discuss (12marks)
- (b) Discuss any FOUR advantages of convertible preference shares (8marks)

QUESTION THREE (20 MARKS)

- (a) Discuss any FIVE importance of valuation concepts and models (10 marks)
- (b) With relevant examples discuss two major approaches to determining the cost of equity of a company (10 marks)

QUESTION FOUR (20 MARKS)

- (a) Valuation of a particular company is a task within the context of the portfolio management process. Each individual valuation that an analyst undertakes can be viewed as a process with five steps. Discuss the Five steps (10marks)
- (b) An analyst conducting an industry analysis must also judge management's strategic choices to better understand a company's prospects for success in competition with other companies in the industry or industries in which that company operates. Porter (1998) may lead analysts to focus FIVE key questions. Discuss (10marks)