

CHUKA



UNIVERSITY

## UNIVERSITY EXAMINATIONS

**SECOND YEAR EXAMINATION FOR THE AWARD OF DEGREE OF BACHELOR  
OF COOPERATIVE MANAGEMENT**

**BCOP 233: CO-OPERATIVE FINANCE****STREAMS: BCOP Y2S2****TIME: 2 HOURS****DAY/DATE: WEDNESDAY 18/04/2018****2.30 P.M. – 4.30 P.M.****INSTRUCTIONS:**

- Answer question ONE and any other TWO questions.
- The present value tables are attached.

**QUESTION ONE (30 MARKS)**

- (a) In an organization, managers are required to make decisions that maximize shareholders' wealth. On the contrary, managers may make decisions that shareholders don't agree with. In view of this. Describe conflicts which may arise between managers and shareholders of a cooperative and suggest how the conflicts can be resolved. (6 marks)
- (b) Discuss the financial goals of a firm. (4 marks)
- (c) Calculate the future value at the end of five (5) years if an investment involves a deposit of sh. 15000 at the end of each year at a compound interest rate of 7.2% p.a. (2 marks)
- (d) The investment manager at Stima SACCO is considering two mutually exclusive projects that have the following characteristics:

Project A: Initial cost sh. 50,000

Scrap value is sh. 10,000

It has the following earnings before depreciation and tax

Year	1	2	3	4	5
EBDT Sh.	30,000	25,000	15,000	12,000	10,000

Project A: Initial cost sh. 60,000

Scrap Value is sh. 10,000

It has the following earnings before depreciation and tax

Year	1	2	3	4	5
EBDT Sh.	15,000	18,000	24,000	30,000	36,000

For both projects, depreciation will be charged per year on straight line basis. Tax rate is 30%. The required rate of return for the firm is 12%.

Advice management on which project to undertake on the basis of:

- (i) Net present value
- (ii) Profitability index
- (iii) Internal rate of return (18 marks)

## QUESTION TWO

- (a) Describe the essentials of sound investment appraisal technique. (5 marks)
- (b) The following information has been extracted form annual report of CIC Ltd. As at 31.12.2016

	Sh.
Ordinary Shares @ sh. 100	2,000,000
10% Loan Stock	1,000,000
Retained Earnings	200,000
8% Preference shares	600,000
Credit sales	800,000
Cash sales	400,000
Debtors	50,000
Cost of sales	900,000
Tax rate	30%
Dividend payout	50%
Market price per share	Sh. 30
Expenses (including interest)	Sh. 280,000

Required: Compute and interpret the following investment ratios

- (i) Average collection period (2 marks)
- (ii) Interest coverage ratio (2 marks)
- (iii) Price Earnings ratio (2 marks)
- (iv) Return on equity (2 marks)

(v) Debt-to-total assets ratio (2 marks)

(c) The following information pertains to two independent projects

Year	Cash flow Sh. 000			
	1	2	3	4
Project A	75	120	150	180
Project B	100	80	70	150

The initial cost of each project is Sh. 300,000. As an investment policy, the firm has set 3.5 years as the standard payback period.

Required: Recommend the most desirable project on the basis of simple payback period. (5 marks)

### QUESTION THREE

(a) Explain the meaning of cost of finance and outline factors that influence the cost finance. (8 marks)

(b) ABC Ltd is the investment firm for Ushirika cooperative society. It has the following capital structure

	Sh. 000
10% Debentures (Sh. 200 par)	4,000,000
Ordinary Shares Capital (Sh. 30 par)	4,500,000
Retained earnings	1,000,000
12% Preference Shares (Sh. 15 par)	1,500,000
5 year, 15% medium term loan	2,000,000
	<b>13,000,000</b>
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#### Additional information:

- (i) Ordinary shares are currently selling at sh. 60 which includes a flotation cost of sh. 10.
- (ii) The shareholders expect a dividend of sh. 5 per share which is expected to grow at the rate of 4%.
- (iii) The 10% debentures are currently selling at a premium of 20% and will mature in 10 years.
- (iv) The 12% preference shares were issued 10 years ago are currently selling at a discount of 10%.
- (v) The market value of the medium term loan is sh. 2,000,000.
- (vi) The applicable tax rate is 30%

**Required;**

- (i) Calculate the component cost of capital and hence weighted average cost of capital (WACC) (8 marks)
- (ii) Distinguish between weighted marginal cost of capital and Weighted Average cost of capital (4 marks)

**QUESTION FOUR**

- (a) Outline the limitations of ratio analysis as a tool of interpreting financial statements (4 marks)
  - (b) A potential investor is seeking information for possible investment in ordinary shares of cooperative bank. The bank currently pays average dividend of sh. 10 per share. The dividends are expected to grow at 12% p.a. for 3 years, 15% p.a. for the next 4 years, 18% p.a. for the next 3 years and finally at 10% p.a. into perpetuity. Calculate the intrinsic value of the share assuming a risk free rate of 10% and a risk premium of 6%. (10 marks)
  - (c) Explain the following sources of finance akin to cooperatives
    - (i) Factoring. (2 marks)
    - (ii) Lease finance. (2 marks)
    - (iii) Mortgage finance. (2 marks)
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