In association with
AL TAREEQAH
Management Studies FZE

SBS
SWISS BUSINESS SCHOOL

Financial Management
SBS _ MBA / MSc
Assignment – Al Ain 2019

STUDENT ID	1	0	2	4	6

UNIT TITLE / CODE :

NAME (in Full): ZFER MEKHAEL HANNA

GENERAL INSTRUCTIONS

- All assignments are to be submitted on **12th December, 2019** on to examinationboard@atmsedu.org and cc to afatima@atmsedu.org.
- Hardcopy submissions on **13th December 2019.**
- Any Assignment submission extension request must come to Dr. Azra Fatima (afatima@atmsedu.org) 5 days before the date of submission with a valid reason and supported documentary evidence.
- If assignment is not submitted on date, will follow with penalty of 10% deduction of marks for every day.
- Similarity between students work is strictly not accepted, any student found with similar work will be graded Zero and fail for the course. However, Plagiarism is an academic offence and will not be tolerated under SBS
- Assignment once submitted to exam board is final for marking.
- Total mark will be converted to 90 & class participation of 10 marks.
  Total 100 marks

GUIDELINES FOR ASSIGNMENT

1. If assignment is Question & Answer based then.
   - Introduction is needed for each question.
   - Question has to be answered based on the mark allotted for each question with references if any idea or information is taken from other source.
2. If assignment is case based then,
   - Executive summary
   - Table of content
   - Body of assignment (questions related to case need to be answered) Conclusion / Recommendation if any
   - References (in-text + citation) to be used.

Total Marks ____________ 90

PLAGIARISM

Plagiarism is a form of **cheating**, by representing someone else's work as your own or using someone else's work (another student or author) without acknowledging it with a reference. This is a serious breach of the Academic Regulations and will be dealt with accordingly. Students found to have plagiarized can be **excluded from the program**.

Plagiarism occurs whenever you do any of the following things without acknowledging the original source:

- Copy information from any source (including the **study guide**, books, newspapers, the internet)□

□

- Use another person's concepts or ideas□

□

- Summarise or paraphrase another person's work.□

How do I avoid plagiarism?

To ensure you are not plagiarising, you must acknowledge with a reference whenever you:

- use another person's ideas, opinions or theory□

□

- include any statistics, graphs or images that have been compiled or created by another □ person or organization□
- Paraphrase another's written or spoken word.□

What are the penalties?

The penalties for plagiarism are:

□Deduction of marks,□□
□A mark of zero for the assignment or the unit, or□□
□ Exclusion from the program.□□

Plagiarism is dealt with on a case-by-case basis and the penalties will reflect the seriousness of the breach.

Please note: claiming that you were not aware of need to reference is no excuse.

Part A

Answer any NINE (9) out of TEN (10) questions.

I will choose (1 to 9) to answer :

1. **Which of the following statements is CORRECT? Rationalize your choice.**

   a. **It is usually easier to transfer ownership in a corporation than it is to transfer ownership in a sole proprietorship.**
   b. **Corporate shareholders are exposed to unlimited liability.**
   c. **Corporations generally face fewer regulations than sole proprietorships.**
   d. **Corporate shareholders are exposed to unlimited liability, and this factor may be compounded by the tax disadvantages of incorporation.**
   e. **Shareholders in a regular corporation (not an S corporation) pay higher taxes than owners of an otherwise identical proprietorship.**

The correct statement is (a)

Rationale:
Ownership interests in a corporation may be sold to third parties without disturbing the continued operation of the business. (It will take few minutes only to buy shares of corporations listed in stock markets via the internet).

While a sole proprietorship cannot be sold whole. Instead, each of its assets, licenses and permits must be individually transferred.

2. **Comment on various methods of capital budgeting. Which method do you think is the most appropriate and why? Justify your arguments with logical reasoning.**

   Capital **b**udgeting (investment appraisal) : is the planning process used to determine whether an organization's long term investments such as new machinery, replacement of machinery, new plants, new products, and research development projects are worth the funding of cash through the firm's capitalization structure. " **Wikipedia"**

And the methods of capital budgeting are **:**

1- Payback period
2- Net Present Value (NPV)
3- Profitability Index
4- Internal Rate Of Return (IRR).

The best capital budgeting method is **N**et **P**resent **V**alue **(NPV)** is, because :

1- The NPV takes into account the basic idea that a future dollar is worth less than a dollar today , in every period the cash flows are discounted by another period of capital cost .
2- The **NPV** also tells us whether an investment will create value for company or the investor , and by how much in terms of dollars .
3- The NPV takes in consideration the cost of capital and the risk inherent in making projections about the future . "The Motley Fool"

References : - Wikipedia
- **T**he **M**otley **F**ool / Fool.com , powered by FactSet and Web Financial Group

3. Blue Red Company decided to issue $700 million of new common stock and use the proceeds to pay off some of its outstanding bonds. Assume that the company, which does not pay any dividends, takes this action, and that total assets, operating income, and its tax rate all remain constant. What affect it can have on the company's financial statements. Discuss.

Since - the total assets, operating income, and its tax rate all remain constant,
& - the bonds are essentially loan agreements,

And paying off the bonds means the interest expense will go down, so the **N**et **I**ncome will increase, and the **R**eturn **O**f **A**ssets (**ROA**) will increase as well .

As conclusion " The company's profit will increase. Since the bonds are essentially loan agreements, so once the company will pay off some of its outstanding bonds that's mean the cash will increase because of not paying the interest of these bonds any more" .

4. What is the difference between liquid and illiquid investment. Explain with the help of an example.

Let's start by defining the **L**iquidity;
Liquidity is sufficient cash on hand to meet financial responsibilities. "Investopedia.com."

- **Liquid investment** can be cash or possessions that could be converted into cash quickly without losing a substantial amount of their value. "Investing Answers"

  For Example
  - Cash in hand
  - Cash at bank
  - Money market assets
  - Marketable equity securities (Stocks)
  - Accounts receivables.

- **Illiquid investment** are assets that cannot be easily sold or exchanged for cash without a substantial loss in value . "Investing Answers"

  For example
  - Penny, Microcap and Nano cap Stocks
  - Ownership interests in private companies.
  - Real estate and production equipment.

References - **I**nvesting **A**nswers .
- **I**nvestopedia.com

5. Why scholars still believe fundamental analysis as a major source decision making for the investors? Discuss.

Fundamental **A**nalysis is : the main method used to evaluate the quality of an investment. In many ways, it is considered the foundation of making informed investments.

Fundamental analysis involves studying the qualitative and quantitative factors that affect the value of a stock, bond, or other kinds of security, the goal of this process is to identify the true value of a security, and investors can use this number as a benchmark to determine whether a security is currently priced under its value, over its value, or at price. "IG Academy"

Scholars still believe fundamental analysis as a major source decision making for the investors because :

1- The fundamental analysis can easily determine the fair value of a company by carefully analyzing the past and present performance of the company, since the fair value helps in deciding whether the company is overvalued or undervalued.

2- Can also Identifying securities that are not accurately priced which allows the investor to purchase stocks that are undervalued, avoid purchasing stocks that are overvalued, and sell overvalued stocks that the investor currently holds .

3- The fundamental analysis is sophisticated analysis process that can provide great insight into the true value of a security . "The street Magazine"

References - IG Academy
- The Street Magazine / thestreet.com.

6. Following four options are available to you. Each option cost $35,000. Each option is going to provide you the revenue for next 3 years.

Asset	Year 1	Year 2	Year 3
Asset 1	$21,000	$15,000	$6,000
Asset 2	9,000	15,000	21,000
Asset 3	3,000	20,000	19,000
Asset 4	6,000	12,000	12,000

Which of the above option a financial manager would choose? Justify your answer with logical arguments.

- The financial manager should choose **The asset 1,** and here below I will explain why : Since the revenue of the asset 1 and asset 3 is $ 42000, and asset 2 is $45000, for three years while the asset 4, is $ 30K which is less than our cost $35000, so asset 4 is out of our choices.

So we will compare the three remained assets(1,2,3).
According to the capital budgeting method **Payback Period** which refers to the amount of time it takes to recover the cost of an investment, which means shorter paybacks mean more attractive investments, that's why we choose the **Asset 1**, since the asset1, will return our cost ($35000) in the second year only, while the second and the third asset will need one more year to return our cost .

7. What are the drawbacks of ratio analysis technique of financial statement analysis? Explain them.

Ratio Analysis is the comparison of line items in the financial statements of business to gain a general understanding of the results, financial position, and cash flows of this business. "Accountingtools" .

The Ratio Analysis is a useful tool. But, there are a number of **limitations (drawbacks)** of ratio analysis to be aware of. And here are some of them :

1- The data we use in the ratio analysis is from actual historical results , but that doesn't mean that the same results we will have it in the future.

2- Ratios ignore the price level changes due to inflation, Once the inflation rate will change in one year, for example: if the inflation rate is 100%, so the sales in that year will appear doubled over the Previous year , but in fact sales doesn't change, that's mean the numbers are not comparable across periods .

3- The firm can make some year-end changes to their financial statements, to improve their ratios. Then the ratios will not be accurate

4- Accounting ratios do not resolve any financial problems of the company, since it is used to measure the efficiency and profitability of a company based on its financial reports . "CFI"

References . - ACCOUNTINGTOOLs .
- "**CFI**" **C**orporate **F**inance **I**nstitution .

8. Contrast between organizational investors and individual investors.

Well, first let's define in some words the Investor and Investing ;
Investor is : an individual that puts money into an entity such as a business for a financial return. The main goal of any investor is to minimize risk and maximize return. "Investopedia"
And Investing : Is The act of putting money into a business or organization to earn a profit . "Investopedia"

Now, Organizational Investors : are an entities or organizations which pool money to buy securities, real property, and other investments assets or original loans.
Organizational Investors include banks, insurance companies, pension and credit unions. "CFI"

Individual Investors are : each person who buys and sells securities, debt, equity, or other investments through a broker, bank, or real estate agent. "CFI"

The differences are :

	Organizational Investors	**Individual Investors**
1 – The decision making process :	- Board of directors along with an investment committee . You're likely dealing with a board of directors along with an investment committee within the board who oversees the consultant, advisor or investment team who is running the portfolio. This group dynamic can be very difficult to manage when you have competing interests, personalities and ideas. Communication, implementing the right investment plan and setting the right expectations is very important in this setting.	- They don't have to worry about decisions-by-committee . Since they are managing their own money . However, many individual investors make trades based on their emotions. They let fear and greed dictate the stocks they buy. They are usually driven by personal goals, such as planning for retirement, saving up for their children's education, or financing a large purchase.

2 - Resources and access	- They can hire in-house or outsourced experts who can provide a wide variety of services & to oversee nearly all aspects of the day-to-day management of their portfolio .	- On their own, since They aren't investing on someone else's behalf, they are managing their own money, although the Internet has leveled the playing field somewhat in terms of research, data availability and market analysis .
3 – Fees And Cost	- They negotiate a fee for each transaction and avoid paying marketing and distribution costs .	– They pay brokerage firm fees along with marketing and distribution costs for each trade
4 – Stocks Invest	- The are Buying stock in hedge funds, pension funds, mutual funds, and insurance companies.	- They are buying stock in publicly traded companies on the stock exchange
5 – Investment Size	- They trade securities in large enough quantities that qualifies for preferential treatment and lower fees	- They buy and sell securities through brokerage firms in smaller quantities, They typically buy stocks in round numbers such as 25. 50, 75 or 100.

References - **SWFI** (Sovereign Wealth Fund Institute)
- **CFI/** Corporate finance institute.com
- Investopedia

9- What do we call the price that a borrower must pay for debt capital? What is the price of equity capital? What are the four most fundamental factors that affect the cost of money, or the general level of interest rates, in the economy?

The **debt capital** is the capital that a business raises by taking out loan , "Wikipedia"
and the price that a borrower must pay for debt capital is **Interest Rate** .

The **equity capital** is funds paid into a business by investors in exchange for common or preferred stock. "Accountingtools.com"
And the price of equity capital : is **Dividend .**

The four most fundamental factors that affect the cost of money are:

1- Production opportunities.
2- Time preferences for consumption.
3- Risk
4- Inflation. "Study.com".

References - Accountingtools.com
- Wikipedia - Study.com

10- The managers of a firm wish to expand the firm's operations and are trying to determine the amount of debt financing the firm should obtain versus the amount of equity financing that should be raised. The managers have asked you to explain the effects that both of these forms of financing would have on the cash flows of the firm. Write a short response to this request.

Part B

Answer any SIX (6) out of SEVEN (7) questions.

I will choose (1 – 2 – 3 – 5 – 6 – 7) to answer

Exercise 1

Discuss preferred and common stock. When does a company apply these stock options? Why equity is considered by some researchers better than debt . Justify with logical arguments.

- The **Common stock**s are securities that represent ownership in a corporation, holders of common stock exercise control by electing a board of directors and voting on corporate policy, and have rights to a company's assets only after preferred stockholders are paid in full. "Thebalance.com"

- The **Preferred Stocks** are securities that are considered "hybrid" instruments with both equity and fixed income characteristics, they normally carry no shareholders voting rights, but usually pay a fixed dividend.

The Preferred stockholders have a higher claim to dividends or asset distribution than common stockholders . "Spaling.com"

And here are the properties of both Stocks :

	Common Stocks	**Preferred Stocks**
1 – Type of Security	- Stock	- Stock
2- Entitlement	Profit & Assets	Profit & Assets
3- Return Potential	Higher Than preferred	Lower Than Common
4- Risk Potential	Higher Than Preferred	Lower Than Common
5- Voting	Yes	No
6 - Dividends	Lower claim to dividends	higher claim to dividends
7 – Liquidation	Claim on asset is Less than Preferred.	Claim on asset is Greater than Common

- When does a company apply these stock options?

- Companies issue Preferred Stock :

- as a way to obtain equity financing without sacrificing voting rights, therefore, have less influence on corporate policymaking decisions and board of director selections.
- preferred stock is callable, so after a set date, the issuer can call the shares at par value to avoid significant interest rate risk or opportunity cost.
- A preferred stock is a crossover between bonds and common shares. "Investopedia"

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- **Companies issue Common Stock :**

If a company has issued only one type of stock, it will be common stock and here below I will explain why the companies issue Common stocks :
- Common stock is listed as an asset on a corporation's balance sheet, and the amount reflected on the balance sheet is its par value.
- If the company goes out of business or is restructured in a bankruptcy, the assets are distributed to bondholders, then Preferred stockholders , and common stockholders are last. In most cases, the common stockholder will receive nothing.
- Company issue common stock to attract the investors, since the most attractive feature of common stock for investors is that its value can rise dramatically over time, as a company becomes more successful its common stock price typically goes up.

"The balance.com"

- Why equity is considered by some researchers better than debt ?

Generally **Debit** involves borrowing money to be repaid, plus interest, while **Equity** involves raising money by selling interests in the company. "FindLaw"

And here are some reasons why some researches considered **E**quity better than **D**ebt :

1. Unlike equity, debt must to be repaid at some point .
2. Interest is a fixed cost which raises the company's break-even point, since high interest costs during difficult financial periods can increase the risk of insolvency, companies that are too highly leveraged (that have large amounts of debt as compared to equity) often find it difficult to grow because of the high cost of servicing the debt.
3. Companies that offer equity in lieu of debt issues can accomplish a lower debt-to-equity ratio and, therefore, gain greater leverage as it relates to future financing needs from new investors.
4. Debt instruments often contain restrictions on the company's activities, preventing management from pursuing alternative financing options and non-core business opportunities.
5. In the case of Debit, the company is usually required to pledge assets of the company to the lender as collateral, and owners of the company are in some cases required to personally guarantee repayment of the loan. "FindLaw / Thomson Reuters"

6. With Equity(stock) a company does not need to make obligatory interest payments to investors and instead can make discretionary dividend payments when it has extra cash. "Guru99.com"

References : - Thebalance.com
- Spaling.com
- Investopedia - Guru99.com - FindLaw / Thomson Reuters

Exercise 2

Glomby Company is financed only with common equity. Its total assets are $780,000. The new CFO wants to employ enough debt to bring the debt/assets ratio to 40%, using the proceeds from the borrowing to buy back common stock at its book value. How much must the firm borrow to achieve the target debt ratio? Show all calculations.

The **D**ebt **R**atio is a financial ratio that measures the extent of company's leverage. "**I**nvestopedia".

Since, Debt ratio = Debt/asset = 40%,
It means , Debt/780,000 = 0.4 ,

So **D = 780,000 * 0.4 = $ 312,000**, is the **amount** must the firm borrow to achieve the target debt ratio.

Reference: **I**nvestopedia

Exercise 3

JBS Inc. recently reported net income of $4,750 and depreciation of $885. How much was its net cash flow, assuming it had no amortization expense and sold none of its fixed assets? How does net cash flow affect managerial decision making?

The **N**et **C**ash **F**low refers to the difference between a company's cash inflows and outflows in given period. "**I**nvestinganswers"

Net cash flow = Net Income + Depreciation.
= $4750 + $ 885
NCF = **$ 5635** .

- How does net cash flow affect managerial decision making?

The importance of the <u>Net Cash Flow (NCF)</u> is that it allows us to rapidly know the company's liquidity, and helping the management in decision making through anticipate the future deficits in cash, and hence help to make the financing decisions beforehand, also It helps us to establish a solid base for requesting credit, and to know if we can purchase in cash or is it necessary to request credit. "**C**onnect**A**mericas.com"

In our case the NFC = $ 5635 (Positive) , and since the company didn't sold any of its fixed assets this means that the JBS Inc. has more money going into its business than coming out, and the company's performance and planning is sufficient , plus the company's liquid assets are increasing, and this will give it a plenty of good decisions and will :

- enabling it to settle debts
- reinvest in its business
- return money to shareholders
- pay expenses and provide a buffer against future financial challenges.

Reference: - **I**nvestinganswers.com
- **C**onnect**A**mericas.com

Exercise 4

Rao Corporation has the following balance sheet

Cash	\$ 10	Accounts payable	\$ 20
Short-term investments		Accruals	20
Accounts receivable	50	Notes payable	50
Inventory	40	Current liabilities	\$ 90
Current assets	\$130	Long-term debt	0
Net fixed assets	100	Common equity	30
		Retained earnings	50
Total assets	\$230	Total liab. & equity	\$230

Required:

a. How much net operating working capital does the firm have?
How does net working capital affect the decision making?

Exercise 5

Following information is extracted from the books of Giant Corporation:

a. **Current Accounts**
   - **2019: CA = 22,900; CL = 15,300**
   - **2018: CA = 17,600; CL = 12,400**

b. **Fixed Assets and Depreciation**
   - **2019: NFA = 98,100; 2018: NFA = 75,700**
   - **Depreciation Expense = 2700**

c. **Long-term Debt and Equity (R.E. not given)**
   - **2019: LTD = 47,000; Common stock & APIC = 1,400**
   - **2018: LTD = 35,850; Common stock & APIC = 1,400**

d. **Income Statement**
   - **EBIT = 22,000; Taxes = 1400**
   - **Interest Expense = 2,840; Dividends = 2,700**

Required:

i. **Compute the cash flow from asset for Giant Corporation.**

Cash Flow = **Operating Cash Flow – Net Capital Spending – Change in net working capital**

Operating Cash Flow = EBIT + Depreciation – Taxes
= 22000 + 2700 – 1400 = **23,300**

Net Capital Spending = Ending net fixed assets – Beginning net fixed assets + Depreciation
= 98100- 75700 + 2700 = **25, 100**

Change in net working capital = Ending NWC – Beginning NWC
= (22900 – 15300) – (17600- 12400)
= 7600 - 5200 = **2400**

So, **Cash flow** = 23,300 - 25, 100 – 2400 = **- 4200**

ii. **Comment on usefulness of cash flow from asset in financial decision making**.

Negative **C**ash **F**low means that the business has more outgoing than incoming money, so the business couldn't cover its expenses from the sales.
And **N**egative **C**ash **F**low from assets, indicates That we are putting more money into long-term success of our company than our actually earning . "Investopedia"

Once our corporation's CF = - 4200 (negative), this means that the corporation is losing money and its operations are not sufficient, and they are putting more money into long-term success of the corporation than earning, and nobody can sustain a business with long-term negative cash flow, and the company will run out of funds if it can't earn enough profit to cover expenses.
Reference : **I**nvestopedia.

Exercise 6

Major Manuscripts, Inc.

2012 Income Statement

Net sales	$17,100
Cost of goods sold	11,200
Depreciation	1,650
Earnings before interest and taxes	4,250
Interest paid	350
Taxable income	$3,900
Taxes	1,300
Net income	$2,600
Dividends	$950

Major Manuscripts, Inc.

2012 Balance Sheet

	2012		2012
Cash	$1,040	Accounts payable	$3,350
Accounts rec.	700	Long-term debt	2,780
Inventory	7,500	Common stock	10,000
Total	9,240	Retained earnings	4,510
Net fixed assets	11,400		
Total assets	$20,640	Total liabilities & equity	$20,640

Required:

a. If Major Manuscripts, Inc. decides to maintain a constant debt-equity ratio, what rate of growth can it maintain assuming that no additional external equity financing is available?

The rate we are going to use here is the Internal Growth Rate which its formula calculated as follow :

- **Internal growth rate = ROA * b / 1- ROA*b**

  where **ROA** is Return On assets
  & **b** is The Retention ratio

- **ROA** = Net Income / Total Asset
  = 2,600 / 20,640 = **0.126**

- **Dividend payout ratio** = dividend / net income
  = 950/2600 = **0.365**

- **Retention ratio (b)** = 1 – dividend payout
  = 1 – 0.365 = **0.635**

- **So, Internal growth** rate = ROA * B / 1- ROA*B
  = 0.126 * 0.635 / 1- (0.126*0.635)
  = 0.08 /0.92 = **8.7 %**

b. How sustainable growth contributes towards the growth of a corporation? Discuss.

Corporations see growth as a good thing, faster a business can grow, the better, right? Actually Not necessarily.

Because In order for a business to grow <u>and Not run</u> into problems with financing, it has to grow at a sustainable growth rate, and businesses have to be able to finance their growth with either debt or equity financing, if they do not have enough financing but have runaway growth, they may find it difficult to get financing to sustain that growth. On the other hand, a business that grows too slowly will stagnate. “the balance.com”.

And this lead us to the <u>definition of Sustainable Growth</u> : which is the realistically attainable growth that a company could maintain without running into problems. “inc.com, encyclopedia”.

So as I mentioned above a business that grows too quickly may find it difficult to fund the growth, and business that grows too slowly or not at all may stagnate.

Let me assume that we have the first situation :
<u>A firm grows faster than you anticipate and actual growth exceeds sustainable growth! What we can do ?</u>
for sure we aren't going to turn down sales, so how we can handle this situation ?
Somebody will say we have several options like :
- **Sell new equity** in order to raise new money,
- **Raise more debt** financing
- **Permanently reduce dividend** payments to shareholders

But we should consider that - **Selling new equity** dilutes the owner's shares, - **raise more debt** pushes the firm nearer to bankruptcy, - **Reducing dividends** always makes shareholders unhappy.

So the goal is always to finding the optimum growth rate, a sustainable growth rate (SGR) which is the maximum growth rate that a company can sustain without having to increase financial leverage.

The models used to calculate sustainable growth assume that the business wants to:
1) maintain a target capital structure without issuing new equity;
2) maintain a target dividend payment ratio
3) increase sales as rapidly as market conditions allow. " the balance.com"

References :
- The balance.com
- inc.com

Exercise 7
1. Blendy Company provides the following balance sheet and income statement for the year of 2017.

BLENDY COMPANY
BALANCE SHEET
AS OF 31 DECEMBER, 2017

ASSETS		**"$"**
Current Assets:		
Cash in hand		**100,000**
Inventory		**90,000**
Debtors		**145,000**
Total current assets		**3,35,000**
Non-Current Assets:		
Building		**1,290,000**
Plant & Machinery		**770,000**
Vehicles 470,000 Total non-current assets	**2,530,000**	
Total Assets		**2,865,000**
LIABILITIES		
Current Liabilities:		
Creditors		**410,000**
Tax Payables		**20,000**
Salary Payables		**92,000**
Total Current liabilities	**5,22,000 Non-Current Liabilities:**	
Long term loan		**10,00,000**
Total Liabilities		**15,22,000**
OWNER'S EQUITY:		
Paid up capital		**740,000**
Retained Earnings 543,000 Share premium	**60,000**	
Total		**1,343,000**
Total Liabilities & Equity		**2,865,000**

BLENDY COMPANY
INCOME STATEMENT
FOR THE YEAR ENDED 31 DECEMBER, 2017

Net Sales	$ 900,000
Cost of goods sold	550,000
Gross profit	350,000
Operating Expenses	90,000
Earnings before interest and tax (EBIT)	260,000
Interest expense	(60,000)
Earning before tax	200,000
Tax (35%)	(70,000)
Earning after tax	130,000

Note: Assume 360 days in a year

Required:

a. Calculate the following ratios:

(i) **Average payment period.**

Average payment period = Account Payable Turnover
= Cost of goods Sold ÷ Account Payable (creditors)
= 550,000 / 410,000 = 1.34 times.

Days = 360 / 1.34 = **268. 66 Days** . the average payment period .

(ii) **Average collection period.**

ACP = Net sale / debtors
= 900,000/145000
= 6.21

Days = 360/6.21= **57.97 days**. The average collection period.

(iii) **Inventory turnover ratio.**

Inventory turnover ratio = Cost & good Sold/operating expenses
= 550,000/90,000 = 6.11

Days = 360/6.11 = **58.92 days**. The inventory turnover ratio.

(iv) **Fixed assets turnover.**

Fixed assets turnover = Net sale/ Total non-current assets
= 900,000 / 2,530,000 = 0.36 %

(v) **Total assets turnover ratio.**

Total assets turnover = Net sales / Total assets
= 900,000 / 2,865,000 = 0.314.

(vi) **Quick ratio.**

Quick Ratio = (Current Assets - Inventory)/Current Labilities
= 335000-90000/522000 = 0.469

(vii) **Return on Equity** .

Return on Equity = Net Income / Total Equity
= (130, 000/ 1,343,000) *100
= 9.67 %

(viii) **Interest coverage ratio** .

Interest coverage ratio = EBIT / Interest Expense

= 260,000/60,000

ICR = 4.33

b. Assuming that the industrial average for collection and payment period is 110 and 150 days respectively and fixed asset turnover is 40%, evaluate the performance of the BLENDY COMPANY based on your answer in part (a) above.

First of all let us define the
- Average Payment Period; and
- Average Collection Period
- Fixed Assets Turnover .

<u>**Average Payment Period(APP);**</u> is the number of days which company takes to pay off credit purchases. "*Orion Capital group*".
The APP is important since it is indicates the creditworthiness of the company.

So according to our case we can see that the other competitors APP is 150 days only, and BLENDY CO's APP is 268, which means they needs 268 days to pay its creditors, which considered long period and the company should <u>revise their payment policy, and try very hard to reduce this period since all mangers should try to make payments</u> promptly to get some profits to their companies for example: avail the discount offered by suppliers, where the discount is available for early payment .

Average collection Period : is the average number of days between the dates that credit sales were made and the dates that the money was received/collected from the customers. "*accounting Coach*"

The Average Collection Period is important since companies calculate it to make sure they have enough cash on hand to meet their financial obligations, and it is most important for companies that rely heavily on receivables for their cash flows.

A lower average collection period is generally more favorable than higher average collection period, a low average collection period indicates that the organization collects payment faster, but there is downsize to this, since it may indicates its credit terms are so strict, customer will seek other competitors and this what will happen with our case, while BLENDY CO's ACP is 58.90 only which considered a strict policy, and the customers for sure will go to the other competitors, since the industrial average for collection is 110 days. so BLENDY CO should revise their collection policy as well, to avoid losing their clients.

Fixed Assets Turnover (FAT) is : an efficiency ratio that indicates how well or efficiently the company uses fixed assets to generate sales. "*Corporate Finance Institution- CFI.com*"

Generally a higher fixed asset ratio implies more effect utilization of investment in fixed asset to generate revenue.
In our case the Fixed Asset Turnover is 0.36, which means that for every one dollar invested in fixed assets, return of 0.36 dollar is earned, and this is low since industrial fixed assets turnover is 40 % , which means the BLENDY Co business is underperforming in sales, and there is inefficiency in regards to managing fixed assets and this gives lower returns on asset investments and both of sales performing and fixed assets managing should be improved. "Corporate Finance Institution- CFI.com"

References : - Orion Capital group

- Corporate Finance Institution- CFI.com

- Accounting Coach