

Course Title : Financial Management

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CHAPTER 1 CASE * Assessing the Goal of Sports Products, Inc.

a) What should the management of Sports products, Inc., pursue as its overriding goal? why? Maximization of shareholder wealth, which means maximization of share price, should be the primary goal of the firm. Unlike profit maximization, this goal considers timing, cash flows and risk. It also reflects the worth of the owners investment in the firm at any times. It is the value they can realize should they decide to sell their shares.

b) Does the firm appear to have an agency problem? Explain. Yes, there appears to be an agency problem, Although compensation for management is tied to profits, it is not directly linked to share price. In addition, management's actions with regard to pollution controls suggest a profit maximization focus, which would maximize their earnings, rather than an attempt to maximize share price.

c) Evaluate the firm's approach to pollution control, pollution. Does it seem to be ethical?

Why might incurring the expense to control pollution be in the best interests of the firm's owners in spite of its negative impact on profits?

The firm's approach to pollution control seems to be questionable ethically. While it is unclear whether their acts were intentional or accidental, it is clear that they are violating the law - an illegal act potentially leading to litigation costs - and as a result are damaging the environment, an immoral and unfair act that has potential negative consequences for society in general. Clear, sports products has not only broken the law but also established poor standards of conduct and moral judgment.

d) on the basis of the information provided, what specific recommendations would you offer the firm?

Some specific recommendations for the firm include:

↳ The management and possibly employees,

compensation to share price or a performance-based measure and make sure that all involved own stock and a stake in the firm. Being compensated partially on the basis of share price or another performance measure, and owning stock in the firm will more closely link the wealth of managers and employees to the firm's performance.

- ↳ Comply with all federal and state laws as well as accepted standards of conduct or moral judgment.
- ↳ Establish a corporate ethics policy, to be read and signed by all employees.

CHAPTER 2 Case & Assessing Martin Manufacturing; Current Financial Position

- a) Calculate the firm's 2003 financial ratios, and then fill in the proceeding table.

Martin Manufacturing company is an integrative case study addressing financial analysis techniques. The company is a capital intensive firm which has poor management of accounts receivable and inventory. The industry average inventory turnover can fluctuate from 10 to 100, depending on the market.

Ratio Calculations:-

Financial Ratio	2003
Current Ratio	$\$1,531,181 \div \$616,000 = 2.5$
Quick Ratio	$(\$1,531,181 - \$700,625) \div \$616,000 = 1.3$
Inventory turnover (times)	$\$3,704,000 \div \$700,625 = 5.3$
Average collection period (days)	$\$805,556 \div (\$5,075,000 \div 360) = 57$
Total Asset turnover (times)	$\$5,075,000 \div \$3,125,000 = 1.6$

Debt ratio	$\$ 1,781,250 \div \$ 3,125,000 = 57\%$
Times interest earned	$\$ 153,000 \div \$ 95,000 = 1.6$
Gross profit margin	$\$ 1,371,000 \div \$ 5,075,000 = 27\%$
Net profit margin	$\$ 36,000 \div \$ 5,075,000 = 0.71\%$
Return on total assets	$\$ 36,000 \div \$ 3,125,000 = 1.2\%$
Return on equity	$\$ 36,000 \div \$ 1,343,750 = 2.7\%$

Historical Ratios

Martin Manufacturing Company

Ratio	Actual 2001	Actual 2002	Actual 2003	Industry Based Average
Current ratio	1.7	1.8	2.5	1.5
Quick ratio	1.0	0.9	1.3	1.2
Inventory turnover (times)	5.2	5.0	5.3	10.2
Average collection period (days)	50	55	57	46
Total asset turnover (times)	1.5	1.5	1.6	2.0
Debt ratio	45.8%	54.3%	57%	24.5%
Times interest earned	2.2	1.9	1.6	2.5
Gross profit margin	27.5%	28.0%	27.6%	26.0%
Net profit margin	1.1%	1.0%	0.71%	1.2%
Return on equity	3.1%	3.3%	2.7%	3.2%
Price earnings ratio	33.5	38.7	34.48	43.4
market / book	1.0	1.1	0.89	1.2

b) Analyze the firm's current financial position from both a cross-sectional and a time-series viewpoint. Break your analysis into evaluations of the firm's liquidity, activity, ~~but~~ debt profitability and market.

Liquidity:

The firm has sufficient current assets to cover current liabilities. The trend in upward and is much higher than the industry average. This is an unfavorable position, since it indicates too much inventory.

Activity:

The inventory turnover is stable but much lower than the industry average. This indicates the firm is holding too much inventory. The average collection period is increasing and much higher than the industry average. These are both indicators of a problem in collecting payment.

Debt:

The debt ratio has increased and is substantially higher than the industry average. This places the company at high risk. Typically industries with heavy capital investment and higher operating risk

try to minimize financial risk. Merita manufacturing has positioned itself with both heavy operating and financial risk. The times - interest - earned ratio also indicates a potential debt service problem. The ratio is decreasing and is far below the industry average.

Profitability - The gross profit margin is stable and quite favorable when compared to the industry average. The net profit margin, however, is deteriorating and far below the industry average. When the gross profit margin is within expectations but the net profit margin is too low, high interest payments may be to blame. The higher financial leverage has caused the low profitability.

Market:

The market price of the firm's common stock shows weakness relative to both earnings and book value. This result indicates a belief by the market that Merita's ability to earn future profits

faces more and increasing uncertainty as perceived by the market.

c) Summarized the firm's overall financial position on the basis of your findings in part b.

Martin Manufacturing clearly has a problem with its inventory level, and sales are not at an appropriate level for its capital investment. As a consequence, the firm has required a substantial amount of debt which, due to the high interest payment associated with the large debt burden, is depressing profitability. These problems are being picked up by investors as shown in their ^{week} market ratio.

CHAPTER # 4.

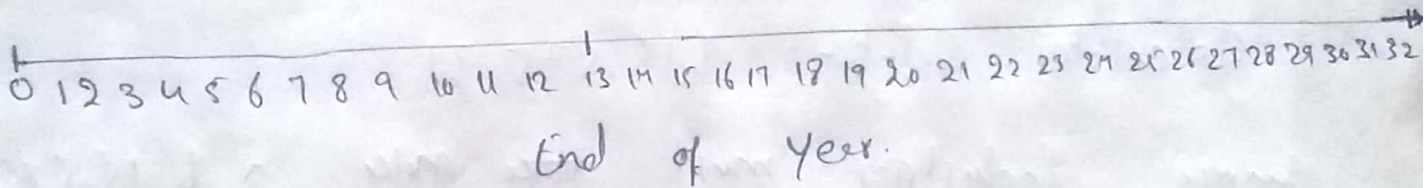
Finding Jill Moran's Retirement Annuity.

- a) Draw a time line depicting all of the cash flows associated with sunrise's use of the retirement annuity.

Cash inflows:

Accumulation Period
12 end-of-year ~~period~~ ^{Deposits:}
Earns interest at 9.6

Cash outflow: Distribution Period
20-end-of-year payment
of \$42,000 balance earns
interest at 12.6



- b) How large a sum must sunrise accumulate by the end of year 12 to provide the 20-year, \$42,000 annuity?

Total amount to accumulate by end of year 12

$$PV_n = PMT \times (PVIFA_{i,n})$$

$$PV_{20} = \$42,000 \times (PVIFA_{12.6,20})$$

$$PV_{20} = \$42,000 \times 7.469$$

$$PV_{20} = \$313,698$$

Calculator Solution: \$313,716.63.

c) How large must Sunrise's equal annual end-of-year deposits into the account be over the 12-year accumulation period to fund fully Ms. Moran's retirement annuity.

End-of-year deposits, 9% interest: $PMT = \frac{FVA_n}{FVIFA_{9\%, n}}$

$$PMT = \$313,698 \div (FVIFA_{9\%, 12})$$

$$PMT = \$313,698 \div (FVIFA_{9\%, 12 \text{ year}})$$

$$PMT = \$313,698 \div (20.141)$$

$$PMT = \$15,575.10$$

Calculator Solution: \$15,575.31

Sunrise Industries must make ~~the~~ \$15,575.10 annual end of year deposit in year 1-12 in order to provide Ms. Moran a retirement annuity of \$42,000 per year in years 13 to 32.

d) How much would Sunrise have to deposit annually during the accumulation period if it could earn 10% rather than 9% during the accumulation period?

End-of-year deposits, 10% interest.

$$PMT = \$313,698 \div (FVIFA_{10\%, 12 \text{ years}})$$

$$PMT = \$313,698 \div 21.329$$

$$PMT = \$14,689.75$$

$$\text{Solution: } \$14,669.56$$

The corporation must make a \$14,669.75 annual end-of-year deposit in years 1-12 in order to provide Ms. Moran a retirement annuity of \$42,000 per year in years 13 to 32.

e) How much would Sunrise have to deposit annually during the accumulation period if Ms. Moran's retirement annuity were a perpetuity and all other terms were the same as initially described?

Initial deposit if annuity is a perpetuity and initial deposit earns 9%.

$$PV_{\text{perp}} = PMT \times (1 \div i)$$

$$PV_{\text{perp}} = \$42,000 \times (1 \div 0.12)$$

$$PV_{\text{perp}} = \$42,000 \times 8.333$$

$$PV_{\text{perp}} = \$349,986$$

End of year deposit.

$$PMT = FVA_n \div (FVIFA_{i,n})$$

$$PMT = \$349,986 \div (FVIFA_{9\%,12yrs})$$

$$PMT = \$349,986 \div 20.141$$

$$PMT = \$17,376.79$$

Calculator Solution: 17,377.54