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Course: Financial Management

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MID TERM ASSIGNMENT.

- Q1: Calculate Gross Profit

$$\text{Gross Profit Margin} = \frac{\text{Gross Profit}}{\text{Sales}}$$

$$0.80 = \frac{\text{Gross Profit}}{40,000,000}$$

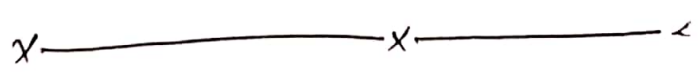
$$0.80 \times 40,000,000 = \text{Gross Profit}$$

$$\text{Gross Profit} = \$ 32,000,000$$

(b) Cost of Goods Sold

$$\text{Cost of Goods Sold} = \text{Sales} - \text{Gross Profit}$$

Sales	\$40,000,000
less: Gross Profit	(32,000,000)
<u>Cost of Goods Sold</u>	<u>\$ 8,000,000</u>



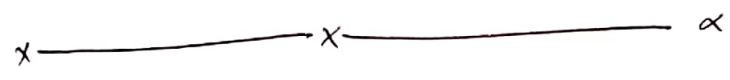
c) Operating Profit

$$\text{Operating Profits Margin} = \frac{\text{Operating Profit}}{\text{Sales}}$$

$$35\% = \frac{\text{Operating Profit}}{\$ 40,000,000}$$

$$\Rightarrow \text{operating Profits} = 40,000,000 \times 0.35$$

$$\text{operating Profits} = \$ 14,000,000$$



d) Operating Expenses

	\$ 32,000,000
Gross Profit	(14,000,000)
less: operating Profit	<hr/>
Operating Expenses	\$ 18,000,000



e) Earnings available for common stockholders:

$$\text{Return on Total Assets} = \frac{\text{Earnings available for common stockholders}}{\text{Total Assets}}$$

$$16\% = \frac{\text{EAFCSH}}{\$ 20,000,000}$$

$$\Rightarrow \text{Earnings available for common stockholders} = \$ 20,000,000 \times 0.16$$

$$= \underline{\underline{\$ 3,200,000}}$$

(f)

Total Assets

(3)

$$\text{Total Assets Turnover} = \frac{\text{Sales}}{\text{Total Assets}}$$

$$2 = \frac{\$ 40,000,000}{\text{Total Assets}}$$

$$\text{Total Assets} \times 2 = \$ 40,000,000$$

$$\text{Total Assets} = \frac{\$ 40,000,000}{2}$$

$$\text{Total Assets} = \underline{\underline{\$ 20,000,000}}$$

————— x ————— x

(g)

Total Common Stock Equity

$$\text{Return on Common Equity} = \frac{\text{Earnings available for Common Stockholder}}{\text{Common Stock Equity}}$$

$$20\% = \frac{3,200,000}{\text{Common Stock Equity}}$$

$$\text{Common Stock Equity} = \frac{\$ 3,200,000}{20\%}$$

$$\text{Total Common Stock Equity} = \underline{\underline{\$ 16,000,000}}$$

————— x ————— x

(h) = Account Receivables

$$\text{Avg Collection Period} = \frac{\text{Account Receivables}}{\text{Avg Sales per day}}$$

$$62.2 \text{ days} = \frac{\text{Account Receivables}}{\$ 40,000,000 / 360}$$

$$62.2 \text{ days} = \frac{\text{Account Receivables}}{111111.11}$$

$$\text{Account Receivables} = \$ 111111.1 \times 62.2 \text{ days}$$

$$\text{Account Receivables} = \$ 6911111.11$$

x-----x-----x

Q: Identify the primary activities of financial Managers ----- How the agency issue is related to it

Financial Management is concerned with the acquisition, financing and management of assets with some overall goal in mind, the financial manager in a firm regulates the above mentioned activities.

A financial manager's primary activities are making investment decisions, and making financing decisions. Investment decisions determine both the mix and the type of assets held by the firm, while the financing decisions tell the mix and the kinds of financing used by the firm.

• ~~The goal of~~
Goal of Firm:

• The ultimate goal of a firm is to maximize wealth rather than profit because profit is "the amount earned during the period on behalf of each outstanding share of common stock, calculated

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by dividing the period's total earnings available for the firm's common stockholders by number of share of common stock outstanding." It fails for a number of reasons

- i- the timing of Return
- ii- Cash flow available for to Stockholders
- iii- Risk

The goal of firm is to maximize wealth of ~~common~~ owners.

Wealth maximization is measured by the share price of stock, which in turn is based on the timing of return, their magnitude and their risk

Agency Issue:

- In theory, most financial managers would agree with the goal of owner's wealth maximization. In practice, managers are concerned with their personal wealth, job security. Consequently managers reluctantly make decision, that taking too much risk might put their jobs

in risk.

The agency problem is the likelihood that managers may place personal goals ahead of firm's goal.

To minimize agency problems, two strands act

(i). Market Forces

(ii). Agency Cost

(i) Market Force:

One market force is major shareholders, particularly large institutional investors such as mutual funds, life insurance companies, and pension funds. These holders of large blocks exert pressure on management to perform. When necessary, they exercise the voting right to replace underperforming management.

(ii) Agency Cost

Stockholders incur agency cost in order to prevent agency issue. These cost monitors management behavior, dishonest acts of management, and providing incentives to managers to maintain firm's overall goal.