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P R I S T I N E

Corporate Finance

- Various Liquidity measures using selected financial ratios
- Operating and Cash conversion cycles
- Components and preparation of a cash forecast
- Tools used in managing a company's net daily cash position
- Comparable yields on various securities and comparison of portfolio returns against a standard benchmark
- Evaluation of the performance of a company's accounts receivable, inventory management, and accounts payable functions
- Choices of short-term funding available to a company

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Liquidity Measures: Ratios

- Current Ratio = Current Assets/Current Liabilities
- Quick Ratio = (Cash + Short Term Marketable Securities + Receivables)/ Current Liabilities
- Cash Ratio = (Cash + Short Term Marketable Securities)/ Current Liabilities

- Receivable Turnover Ratio = Net Annual Sales*** / Average Receivables
- Average Collection Period = 365/ Receivable Turnover Ratio (or)
= Average Receivables/ Average day's credit sales

***Credit sales is used instead of Annual sales when the information is available.

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- Inventory Turnover Ratio = $\text{COGS} / \text{Average Inventory}$
- Average Inventory period = $365 / \text{Inventory Turnover Ratio}$ (or)
= $\text{Average Inventory} / \text{Average day's COGS}$
- Payable Turnover Ratio = $\text{Purchases} / \text{Average Payables}$
- Average Payment Period = $365 / \text{Payable Turnover Ratio}$ (or)
= $\text{Average Payables} / \text{Average day's purchases}$

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- The **operating cycle** is the average number of days that a firm takes to turn raw materials into cash proceeds from sales.

Operating Cycle = Average Inventory Period + Average Collection Period

- The **cash conversion cycle** or NET operating cycle is the length of time it takes to invest the firm's cash investment in inventory into receivables and receivables back into cash taking into account the credit period from suppliers.

Cash Conversion Cycle = (Average Collection Period + Average Inventory Period) - Average Payment Period

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Cash Forecast

- Classification of the components
 - Cash inflows include: Amount received from customers, dividend and interest income on investments, receipts from matured investments, Refund of tax.
 - Cash outflows include: Trade payables to vendors, wages and salaries, investments made, interest on loan, dividend declared and various taxes paid.

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Management of net daily cash position

- The purpose of managing a firm's daily cash position is
 - Maintain target cash balance
 - Excess cash balance results in an opportunity cost of the interest that could have been earned on short term securities.
- Short term Instruments:
 - Treasury bills
 - Time deposits
 - Repos and reverse repos
 - Commercial paper
 - Money market mutual funds

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Comparable yields on securities

- Discount Basis Yield: $(FV-P)/FV * (360/\text{days to maturity})$
- Money Market Yield: $(FV-P)/P * (360/\text{days to maturity})$
- NOTE the **difference in the denominator**
- Bond equivalent Yield: $(FV-P)/P * (365/\text{days to maturity})$
 - This is a measure used for short term securities.
- Features of Cash Management Investment Policies (Example - PSU's)

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- Evaluation of the performance
 - Accounts Receivables Management
 - Preparing an Aging Schedule and how it changes over time
 - Inventory Management
 - Various for different Type of industry
 - Cost of Stock Out situation v/s Cost of Obsolete items
 - Accounts Payable function
 - Stand off between discount on early payment v/s Effective utilization of credit period.

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Short term funding

- Choices of short-term funding available to a company
 - Lines of Credit: Uncommitted, Committed and Revolving
 - Banker's acceptances, used by exporters
 - Factoring to discount receivables
 - Commercial Paper
 - Short Term Loans from NBFCs

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