

# SEMESTER SPRING 2012

## Corporate Finance (Fin 622)

### Assignment No. 02

**Due Date: 19-06-2012**

**Marks: 25**

#### Learning objectives:

To develop an understanding of working capital management and economic importance for financial planning & forecasting on short term basis

#### Outcomes:

After completing this assignment students will be able to understand:

- how working capital requirements of any business organization are determined; &
- how “cash and inventory” are two important components of working capital management.

#### Case

Super Manufacturing Company (SMC) is a medium scale but highly profitable unit engaged in the processing of food items contributing well in the country's Rs. 1,000 million food industry. The company's after tax profit has been reached to the tune of 63% over the past 7 years. Much of this is due to the efforts put in by its Financial Planner – Mr. FP, whose success can be traced to *financial planning and forecasting* of short term assets and liabilities. But, still he is much concerned about working capital management to maintain a balance between liquidity and profitability of the company. For this, he along with his team has chalked out an estimate about the company's overall working capital needs. He has also done detailed analysis of cash and inventory to determine optimal level for the working capital for the Financial Year 2013.

The following are the estimates in this regard:

Particulars	Rs.
Sales	1,500,000
Material <i>Alfa</i>	450,000
Direct Labor	375,000
Factory Overhead (fixed and variable)	225,000
<b>NOTE:</b> <i>All above figures are annual estimates.</i>	
Credit terms	Month(s) (period)
Material <i>Alfa</i>	1½
Direct Labor	2
Factory Overhead Expenses - fixed and variable (Cash)	2½

SMC takes 1½ month to materialize its account receivables in cash. Material *Alfa* is held in the stock for a quarter. Work in process remains in the production for 30 days to complete. It takes 2 months to sell the finished goods held in the stock.

## **Required:**

1. Figure out the working capital requirement (net) for the year 2013;  
(12 Marks)
2. Mr. FP can arrange cash from a local bank in multiple of RS. 50,000 at a fixed cost of Rs. 2,500 for each multiple, whereas interest rate is 15% and deposit rate is 8%. What would be the optimal cash holding level for SMC at this point of time to meet annual requirements of Rs. 150,000? Also determine the number of years, this finance (optimal cash level) will be enough for SMC?  
(5 marks)
3. To meet the above estimated annual sales, monthly requirements have been determined at 500 kg of material *Alfa*. Present ordering cost is Rs. 70 per order, whereas material *Alfa* is priced at Rs. 75 per kg. Holding cost is estimated at 3% of the purchase price. At present, its monthly requirement is 500 kg. EOQ has been determined at 611kg. Recently, the supplier has offered SMC a trade discount of 3% subject to the order size of 300 kg. Determine whether the new discount policy is acceptable to SMC or not. Support your answer with complete working.  
(8 marks)

**(Formulas and complete working is mandatory, as it carries marks)**

## **Note:**

Only in the case of Assignment, *24 hours extra / grace period* after the due date is usually available to overcome uploading difficulties which may be faced by the students on last date. This extra time should only be used to meet the emergencies and above mentioned due dates should always be treated as final to avoid any inconvenience.

## **Important Instructions:**

Please read the following instructions carefully before attempting the assignment solution.

### **Deadline:**

- Make sure that you upload the solution file before the due date. No assignment will be accepted through e-mail once the solution has been uploaded by the instructor.

### **Formatting guidelines:**

- Use the font style "Times New Roman" / "Arial" and font size "12".
- It is advised to compose your document in MS-Word 2003.
- Use black and blue font colors only.

### Solution guidelines:

- Every student will work individually and has to write in the form of an analytical assignment.
- Give the answer according to question.
- For acquiring the relevant knowledge don't rely only on handouts but watch the video lectures and use other reference books also.

### Rules for Marking

Please note that your assignment will not be graded or graded as Zero (0) if:

- It has been submitted after due date
- The file you uploaded does not open or is corrupt
- It is in any format other than .doc (MS. Word)
- It is cheated or copied from other students, internet, books, journals etc...

**Best OF Luck!!**