

# Kami Chickens and Their Perspective of the Financial Future

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# GENERAL PERSPECTIVE

The company Kami processes and commercializes chicken in re-sealable bags. In June of 2023, Emilio Garcia, CEO, is getting ready to face the next three years so he has requested the Finance team to prepare a general budget of the income statement, general balance, and cash flow for that period. Emilio knows that at the beginning of the following year he must get credit to finance operations, he wants to pay it back, but he also wants the leveraging of the business to be between 20% and 30% in years 2 and 3 respectively.

Image. Pressfoto in Freepik, 2023.



# BUDGET

## YEAR 1

It is clear for Emilio Garcia that he can have a very detailed budget for year 1 as the managers who help him have the necessary information, such as the sales that have already been agreed with customers and the prices that have been negotiated with suppliers.

For years 2 and 3, Emilio knows that the budget will be a little bit more general, but that he can also develop it with indicators such as inflation, the industry growth, and some parameters that he would like Kami to meet.

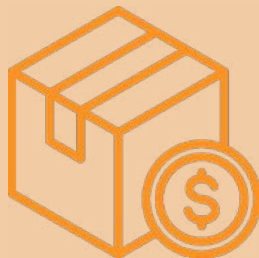


Information 1 Kami Chicken

Images. QudaDesign, Uniconlabs and Freepik in Flaticon, 2023.



Currently, Kami has three skus (stock keeping units) that are sold in self-service stores, central markets, convenience stores, and large format retailers. Each sku refers to a code and a description that varies according to the number of pouches of each box and to the grams of each of the pouches.



The price is handled per pouch and the sales volumes per box. The prices per box for the following year including the inflation increase are presented **(see spreadsheet number 1 “Sku”)**.



The sales manager has already made a projection of the sales for year 1 after considering the growth of the industry **(see spreadsheet 2 “Sales”)**; he knows that in order to calculate sales in cash, first you must have the price per box and then multiply it by the number of boxes per quarter of year 1.

# ACQUISITIONS AND PRODUCTION BUDGET

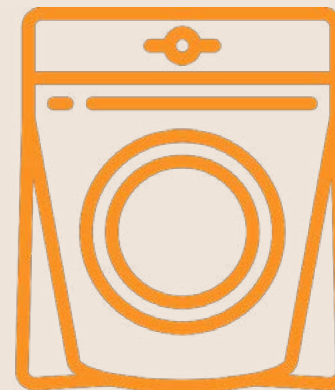
The Production Manager has certain information about inventories that enables him to know the production and acquisitions budget and how physical inventories will end up, both of finished product and of raw material for the end of 2023 (**see spreadsheet 3 “PT Inventories”**), (**see spreadsheet 4 “MP Inventories”**). For years 2 and 3 it is intended to maintain a 3% total inventory regarding sales.

Images. Nikita Golubev and GOWI in Flaticon, 2023.



## RAW MATERIAL

It is intended to keep a final inventory that corresponds to 10% of what will be used for the production in that same quarter.



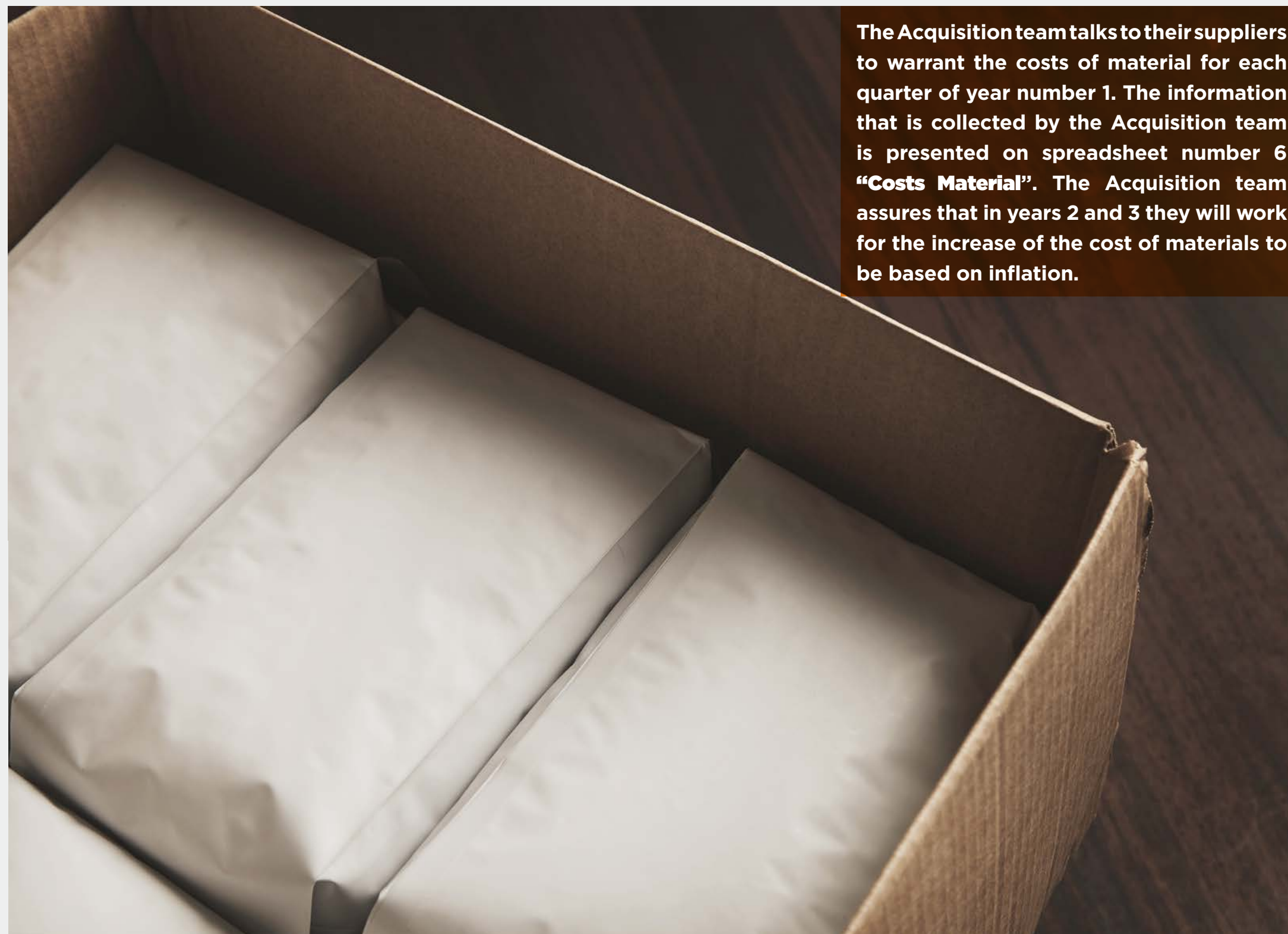
## FINISHED PRODUCT

It is the company's policy to have a final inventory of 10% of the sales that were estimated for that quarter.

# THE RECIPES

The Production manager has a recipe for each of the skus where the use of materials for the elaboration of each box that will be produced is shown. Each recipe shows the amount of each sku without loss and with loss. For the case with no loss, it is indicated how much the product should have if the process were perfect and with no waste. Nevertheless, the Production team has made some calculations that identify a loss of material throughout the process. Therefore, the manager of this department warns that the estimation must include an amount with loss (**see spreadsheet 5 “Recipes”**).

Image. Bublikhaus in Freepik, 2023.



The Acquisition team talks to their suppliers to warrant the costs of material for each quarter of year number 1. The information that is collected by the Acquisition team is presented on spreadsheet number 6 “**Costs Material**”. The Acquisition team assures that in years 2 and 3 they will work for the increase of the cost of materials to be based on inflation.

# WORKFORCE AND INDIRECT MANUFACTURING EXPENSES

To calculate the cost of the workforce and the indirect expenses of manufacturing, the Engineering team calculates the time of manufacturing for each of the pouches. Costs must include the number of pouches that can be manufactured within one hour.

The table that is presented on **spreadsheet number 7 "Time of processing"** shows how many pouches can be processed in 60 minutes. It is important to mention that after obtaining the cost per pouch, the cost per box must be calculated.

The Finance and Production teams are also working on developing the total budget of workforce for year 1, which will be of 7.8 million pesos (MXN) and the budget for indirect manufacturing costs will be of 5.3 million pesos (MXN), both pieces of information per quarter. The total amount of both budgets will increase each year according to inflation indexes. To calculate year number 2, it is considered that the expenses estimated for the four quarters of year one must be added. As part of the budget of the indirect manufacturing expenses, depreciation has already been included.



Image. Usertrmk in Freepik, 2023.

**\*Of sku 40000, three thousand pouches can be processed in an hour, while from sku 40012, 250 pouches are processed in an hour. This means that as the sku 40000 pouches can be manufactured faster, the cost per pouch will be much cheaper.**

# TEAM INVESTMENTS

In order to keep the industry's growth, Emilio feels that he should buy new equipment. The machinery and equipment that they have currently was bought five years ago at a cost of 30 million pesos (MXN) and a useful life of 10 years. For this purchase, a credit was taken out which is being currently paid. In order to sustain the coming growth, they are considering the purchase of new machinery for 12 million pesos (MXN) in the first quarter of year 1, which would also be depreciated in 10 years. For this, a credit of 10 million pesos (MXN) is necessary. For the end of year 3, they have planned to make an investment on equipment for 15 million pesos (MXN) which will not affect the depreciation of year three and which will be paid in cash at the end of that year. From the previous credit and the new credit, it is expected to disburse 300 thousand pesos (MXN) per quarter of which 200 thousand pesos (MXN) will be allotted to paying interest and 100 thousand (MXN) to capital. This is also planned to happen in years 2 and 3.



Image. Our-team in Freepik, 2023.

# END OF THE YEAR

In June, the Finance team is getting ready to present the financial planning of years 1, 2, and 3, elaborating a calculation of how the general balance of this year will close. The manager shares with Emilio that this will be the turning point to make some estimations for the next three years (**see spreadsheet 8 “General balance”**).

Emilio knows that his business makes a certain amount of cash, so he pretends to keep a cash balance that will enable him to face any eventuality that the company can have. He is also aware that he must continue growing over time, as a sales increase is expected for the following years. The cash balance that must be kept each quarter are the following:

Quarter 2 - \$2,500,000 (MXN)

Quarter 3 - \$2,500,000 (MXN)

Quarter 4 - \$3,000,000 (MXN)

The remaining money must be allotted to the payment of credits and the remaining cash will be allotted to paying off the debt. For years 2 and 3 there is a leverage objective of 20 to 30%

Image. Pressfoto in Freepik, 2023.



The finance manager estimates that the accounts receivable represent a month of sales. Regarding the accounts payable, they represent 20% of the cost of sales of that quarter. In the calculation of accounts payable of years 2 and 3, the cost of sales must be considered divided by 4 (to obtain it by quarter) and then multiplied by 20%

## THE DECISION

Emilio Garcia wants to know the income statement and the general balance of years 1,2, and 3. He is wondering, assuming that equipment and machinery with a cost of 15 million pesos (MXN) were bought in cash at the end of year 3, and keeping a leverage between 20 and 30%, how much will he pay for the credits every year?