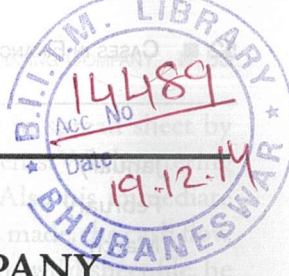


Case 10



KHANNA MANUFACTURING COMPANY

DISCUSSION QUESTIONS

1. Prepare cash forecast for KMC by completing Exhibit I of the case.

Khanna Manufacturing Company Limited (KMC) is engaged in manufacturing rubber-based products used in a variety of commercial applications. The company is located in Noida near Delhi and is one of the leading suppliers of these products to a large number of companies engaged in manufacturing automobile accessories, electronic and light engineering products. In recent years, the competition in this type of business has intensified. KMC has been able to face this competition and has been growing rapidly. The main reasons for its growth have been its good image for quality products, technological improvements leading to increased production capacity, cost advantage and strong marketing team.

During the last two years of operation, the company has been facing frequent cash deficit problems, as a result of which the company has not been able to meet its obligation to pay to its suppliers in time, and this has forced the company to postpone its payments. The company's reputation as a credit-worthy customer has gone down. Mr. Khanna speculates that if this experience is repeated, the suppliers would force the company for cash payments for its purchases. To prevent the occurrence of this type of unforeseen events, he wanted to plan his cash in a better way.

Mr. Khanna asked his finance manager Mr. V P Iyer to develop the monthly cash forecasts for the period starting from January 2011 to June 2011. Mr. Iyer obtained the following actual sales figures from the records of the last three months:

| | | (Rs. in lakh) |
|----------|------|---------------|
| October | 2010 | 240 |
| November | 2010 | 280 |
| December | 2010 | 320 |

Mr. Iyer first tried to find out the sales forecasts for the next seven months. After consulting with Mr. Khanna, he developed the following forecasts:

| | | (Rs. in lakh) |
|----------|------|---------------|
| January | 2011 | 260 |
| February | 2011 | 210 |
| March | 2011 | 160 |
| April | 2011 | 240 |
| May | 2011 | 200 |
| June | 2011 | 160 |
| July | 2011 | 200 |

Over the past three years, KMC had averaged 25 per cent of the company's total sales as cash sales, the remaining 75 per cent of the sales being accounts receivable. Forty per cent of these accounts receivables were collected in the first month after sales, 30 per cent collections took place in the second month after the sales and the remaining receivables were collected in the last month.

KMC's average consumption of raw material is 80 per cent of the sales. The accounts indicated that 40 per cent of this is paid in the month of sales itself, 55 per cent in the following month and the remaining in the third month.

Mr. Iyer anticipated payments for wages and salaries to be as follows:

| | (Rs. in lakh) |
|----------|---------------|
| January | 42 |
| February | 39 |
| March | 32 |
| April | 40 |
| May | 32 |
| June | 28 |

The other general administrative expenses were assumed to be about Rs. 2.5 lakh per month. Mr Iyer was aware of the 16 per cent annual interest payment liability on Rs. 20 lakh of borrowing to be paid in the month of March. A tax payment on 2010 income of Rs. 2.5 lakh is due in April. Mr. Iyer estimated that KMC's tax liability for the next accounting year is expected to be Rs. 24 lakh, for which the company would be required to pay the tax in advance. Quarterly instalment of such liability would be due in March, June, September and December. He also found that a capital expenditure of Rs. 70 lakh is planned in February, of which 50 per cent will have to be paid in the same month and the remaining in May. The company has a cash balance of Rs. 1,40,000 as on December 31, which is the minimum desired level of cash. For projecting the cash flows for the next six months, Iyer assumed the prices and costs to remain constant.

After collecting the information about cash flows, Iyer created a file in spread sheet by classifying each item of cash flows systematically into cash receipts and payments. While entering the amounts of cash flows he was not sure how to input these figures. Also his immediate concern was that as and when any change in sales or collection experience is made, the cash flow forecasts should automatically get updated. Before entering the figures in the worksheet file, he wanted to plan it more systematically.

DISCUSSION QUESTIONS

1. Prepare cash forecast for KMC by completing Exhibit I of the case.
2. What are assumptions you have made in preparing this cash flow? What if some of these assumptions change?
3. Where should company put its effort to improve its cash flow position?