

## Financial Management. Chapter 2. Capital budgeting analysis

### Crazy Cow

The Spanish company "Crazy Cow, S.A." has been dedicated to the breeding and sale of cattle for the past 10 years. It was a pioneer in the use of artificial food of British origin, cheaper than the Spanish natural food. Recently, in a medical control, the government has decreed the sacrifice of all its cows, after having detected in one of them the "mad cow" virus. But the shareholders of Crazy Cow do not give up, and now they are willing to start over. After examining the results of a study about the prospects of the pig industry during the nearby future commissioned to a leading consulting firm (cost of 25,000 € paid at the end of 2018), the Strategic Planning department has to decide about the investment described below.

The plan consists of entering the pig market. The cost of the new infrastructure amounts to 0.9 million euros (to be paid at the end of 2018), considering a useful life of 5 years from its start-up and a salvage value of 0.1 million. The initial investment is made at the end of the current year (year 2018). The facilities for the new plant will be built in a warehouse the company owns that is currently used as a parking lot (generating annual income of 50,000 € before taxes). The investment will be 50% financed with a long-term loan at 6% interest rate.

The first year of activity, the firm expects to sell 1,000 pigs at 750 euros per unit (constant for all years). The number of pigs sold will grow by 10% each year.

Operating expenses:

	% over sales	
Cost of sales	30%	paid at 60 days
Wages	15%	paid in cash
General expenses	12%	paid in cash
Supplies	10%	paid at 30 days

On the other hand, the company considers necessary for the operation of its activity to have a cash balance equivalent to 5% of sales, and a level of inventory equivalent to 30 days of sales. Sales are collected at 30 days. The tax rate of the company is 30%.

If the minimum required return on this investment is 7%, should it be carried out?