

Biocom, Inc. Case Study x University of Phoenix Fin x

Secure | <https://phoenix.vitalsource.com/#/books/9781323331347/cfi/8/6/4/2/34/8/2/2@0:0>

## MINI-CASE BioCom, Inc.: Part 2, Evaluating a New Product Line

This mini-case is available in MyFinanceLab.

BioCom, Inc. is weighing a proposal to manufacture and market a fiber-optic device that will continuously monitor blood pressure during cardiovascular surgery and other medical procedures in which precise, real-time measurements are critical. The device will continuously transmit information to a computer via a thin fiber-optic cable and display measurements on several large monitors in view of operating room personnel. It will also store the data and display it graphically for review during or after procedures. BioCom will market various versions of the device, but manufacture all of them in the same facility using the same equipment. The versions will have similar markups and cost structures. If management decides to bring this device to market, BioCom will stop selling an earlier, less sophisticated version of the monitor. The product that BioCom will discontinue now contributes about \$1,650,000 per year to operating cash flow, and projected sales are flat. BioCom focuses exclusively on cutting-edge applications, so it expects to discontinue the new monitor after five years. At that time, it will sell the technology and used manufacturing equipment to a foreign company for an estimated \$2,400,000.

Cost analysts have collected the following figures and submitted them to the treasurer's office for additional study and a final decision on whether to proceed. You, as assistant to the treasurer, must

Type or talk 3:40 PM 1/30/2017

Biocom, Inc. Case Study x University of Phoenix Fin x

Secure | <https://phoenix.vitalsource.com/#/books/9781323331347/cfi/8/6/4/2/34/8/6@0:76.8>

projected sales are flat. BioCom focuses exclusively on cutting-edge applications, so it expects to discontinue the new monitor after five years. At that time, it will sell the technology and used manufacturing equipment to a foreign company for an estimated \$2,400,000.

Cost analysts have collected the following figures and submitted them to the treasurer's office for additional study and a final decision on whether to proceed. You, as assistant to the treasurer, must compute and evaluate the basic capital budgeting criteria. The project will initially increase working capital by \$480,000, which the company will recover at the end of the project when it sells remaining inventory and collects accounts receivable. The analysts are not quite sure if they should include \$450,000 that the company already spent on research and development for the new product. They also disagree about whether the effect of the discontinued monitor on the company's overall operating cash flows is relevant to the decision on the new product line, so you must decide how to deal with these two items.

Cost of new plant and equipment	\$24,000,000
Designs and prototypes	\$ 450,000
Estimated salvage value of technology and equipment, end of year 5	\$ 2,400,000

Type or talk 3:40 PM 1/30/2017

Biocom, Inc. Case Study x University of Phoenix Fin x

Secure | <https://phoenix.vitalsource.com/#/books/9781323331347/cfi/8/6/4/2/34/8/10/2/2/6/2/2@0:100>

First-year sales forecast	\$16,500,000
Projected annual rate of sales increases	6%
Cost of goods sold	40% of sales
Selling, general, and administrative expenses	5% of sales
Annual fixed cost	\$600,000
Operating cash flow from current desk sales	\$1,650,000
Economic life of the project	5 years
Initial change in net working capital	\$480,000
Depreciation	5-year MACRS

Type or talk 3:39 PM 1/30/2017

Biocom, Inc. Case Study x University of Phoenix Fin x

Secure | <https://phoenix.vitalsource.com/#/books/9781323331347/cfi/8/6/4/2/34/8/10/2/2/6/2/2@0:0>

Tax rate	34%
Discount rate = cost of capital	9%

### QUESTIONS

1. What is the total relevant initial investment for BioCom's new product line? Would you include the designs and prototypes? Would you include the change in net working capital?
2. What is the cash flow resulting from disposal of the equipment at the end of the project?
3. Compute a schedule of depreciation for the plant and equipment.
4. Compute a schedule of operating cash flows for BioCom's new product.
5. Compute a schedule of incremental cash flows for BioCom's new product.
6. Compute the project's net present value.
7. Does your answer to Question 6 indicate that management should accept or reject the product?

Ask me anything 3:38 PM 1/30/2017