

The Three-Year Price

Student brief

Sagamu Packaging Ltd makes corrugated cartons at a single plant in Ogun State. It has been trading for eleven years, it is profitable, and it has never had a customer larger than four percent of its sales.

Last week a multinational food manufacturer with three plants in Nigeria offered it a three-year supply contract: 1.2 million cartons a year, delivered monthly, at a fixed price of ₦250 per carton. The volume is guaranteed. The price is not negotiable after signature.

The contract would be twenty-eight percent of Sagamu's output. The managing director has already told his family he intends to sign it.

The finance director has asked Mountain River for a read before Friday.

Exhibit 1 • The contract, costed at today's prices

YEAR 1 • AT THE CONTRACT PRICE

₦ millions unless stated

LINE	AMOUNT
Cartons a year (millions)	1.20
Price per carton	₦250
Revenue	300.00
COST	
Imported kraft paper, ₦100 per carton	120.00
Local conversion — starch, ink, power, labour, ₦100 per carton	120.00
Fixed overhead attributable to the contract	40.00
Total cost	280.00
RESULT	
Operating profit	20.00
Operating margin	6.7%

The kraft paper is bought from a mill in Europe and invoiced in dollars. Everything else is bought and paid for in naira. All of Sagamu's revenue is in naira, from Nigerian customers.

Exhibit 2 • Treasury's planning assumptions

These are the assumptions Sagamu's own board approved in August for all three-year planning. The compounding factors are worked out for you.

PLANNING ASSUMPTIONS • APPROVED AUGUST

ASSUMPTION	YEAR 1	YEAR 2	YEAR 3
Naira consumer price inflation, 23% a year	1.0000	1.2300	1.5129
Naira depreciation against the dollar, 30% a year	1.0000	1.3000	1.6900

The dollar price of kraft paper is assumed flat across the three years. Treat the naira cost of the paper as moving with the exchange rate, and the local conversion cost and the fixed overhead as moving with consumer price inflation.

Question 1 • 15 minutes

Build the contract's operating profit for **years 1, 2 and 3** at the fixed price of ₦250 per carton.

Then state the three-year total **twice**: once in naira of the day, and once in **year-1 purchasing power**.

Say which of the two figures you would put in front of the managing director, and why.

Question 2 • 13 minutes

The sales director has read your Question 1 and proposes a fix: a clause raising the price each year by Nigerian consumer price inflation. He has checked, and the customer will accept it.

Does it solve the problem? Show the year-3 position under the escalator.

Then answer the harder question: if a consumer-price escalator is not the right clause, **what is the right one** — and what number would you put in it?

Question 3 • 9 minutes

Four options are on the table.

- Sign at the fixed ₦250.
- Sign with the consumer-price escalator.
- Insist the price be set in dollars and settled in naira at the prevailing rate.
- Offer a one-year contract, repriced annually by agreement.

Choose one, and say what you would tell the customer to get it.

The managing director has already told his family he is signing. He is in the room.