

HIND PETROCHEMICALS COMPANY

The petrochemical plants of Hind Petrochemicals Company (HPC) are situated in the South and East of India. The Company wants to expand in the West. HPC's existing refinery capacity is 9.5 metric ton. The central government has a refinery in a remote area of western India with a capacity of 3.5 metric ton. HPC has strategic interest in acquiring the refinery. As a part of its privatization policy, the central government is willing to sell the refinery for Rs. 1,550 million. The company is in touch with the government for the purchase of the refinery for the last few months.

According to the company-appointed valuers, the refinery would need an additional investment of Rs. 5,950 million in machineries and Rs. 300 million for working capital before starting the operations. According to the valuer, if the company so desired, the refinery including these facilities (including working capital) could be sold for Rs. 3,800 million after the planning horizon of five years. In that case, the company will have to incur Rs. 200 million at the end of the economic life of the refinery to clean the site. The initial cost of valuers' work was Rs. 25 million. They will be paid an additional amount of Rs. 15 million in the first year if the company buys the refinery.

The corporate planning department of the company has estimated the profit from the refinery operation as given in Exhibit I.

The company has a policy of charging depreciation on straight-line basis. However, for tax purposes, the WDV depreciation on the block of assets applies. The depreciation rate is 25 per cent. Corporate overhead costs include the three-fourths costs as the corporate overhead allocations and one-fourth costs incurred by the corporate office exclusively for the proposed project. The company proposes to finance the projects mostly by raising a 5-year 10 per cent loan from a financial institution. The management of the company feels that the investment in the refinery has the same risk and debt capacity as the current business; it must yield a return of 15 per cent.

The executives of the company are not unanimous on accepting the project. The financial controller's recommendation is to reject the project as it earns profits only in the first two years of the five-year period. The production manager considers the location as a strategic advantage since the company will have a plant in the West and could meet the demand easily. The marketing manager argues that the company should look at the investment's payback period. According to

her, the depreciation included in the profit estimates is the recovery of the investment, and in addition, the company also earned profit in the first two years.

DISCUSSION QUESTIONS

1. Should the project be accepted? Use the most suitable method of evaluation to give your recommendation and explicitly state your assumptions.
2. Does your decision to accept the project change if you use other methods of evaluation? Show computations. Do you agree with the views of the financial controller, the production manager and the marketing manager?
3. Why do you think that the method chosen by you is the most suitable method in evaluating the proposed investment?

Profit after tax	450	480	0	-650	-240
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PROJECT/IDBA

Chandigarh, where Sunil lives, is situated at about 250 km Northwest of Delhi on the National Highway No. 1, which runs between Delhi to Wagah International Border. The city is beautifully planned by Mr LeCarbusier, a well-known French architect, that it is known as the City Beautiful. Chandigarh is surrounded by historical places as well as good picnic spots and hill stations. To its north are Shimla and the Pinjore gardens where the Pandavas were said to have lived during their exile. To the north west is Anandpur Sahib where the ninth Sikh Guru, Guru Teg Bahadur, was cremated, and also the Bhakra Nangal Dam. To its west are industrial towns of Ludhiana and Jullunder, and also the famous Golden Temple at Amritsar; and beyond that is the Wagah International Border where the Sounding of the Last Post is an attraction for tourists. To the south of Chandigarh is the famous old city of Patiala with its wonderful museum of old weapons, and to its east is the popular Karna Lake which is a great picnic spot.

With all these attractions in and around Chandigarh, there is a very good potential to run a tourist bus service. At present, there is hardly any good tourist bus service. Train services are available, but they are time-consuming as well as inconvenient.

All this prompted Sunil Mehra to think of starting a tourist bus service based in Chandigarh. He has done some market survey. He is convinced that there are no good services at Chandigarh to cater to the touring needs of the upper class people, who are prepared to pay for a good tourist service, if it is available. He has also contacted some of the hotels in and around Chandigarh and was assured support if he could run a good bus service.

Exhibit I**PROFITABILITY PROJECTIONS***(Rs. in million)*

	Year				
	1	2	3	4	5
Sales	5730	5930	5870	3790	4500
Wages and salaries	1450	1500	1850	1030	1210
Selling and distribution costs	760	770	1080	530	650
Materials and consumables	180	270	290	200	230
Depreciation	1500	1500	1500	1500	1500
Corporate office costs	400	400	400	400	400
Survey costs	40	—	—	—	—
Interest	750	750	750	750	750
Profit (loss) before tax	650	740	0	-620	-240
Less: Tax @ 35%	230	260	0	0	0
Profit after tax	420	480	0	-620	-240

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