Victoria chemicals

I am pleased to share my concerns, analysis and recommendation about the Merseyside Project with you. Your DCF analysis is excellent and helpful. However, I have to make some changes to it. The memo will be divided into 6 parts. ? Suggestions for Merseyside project: P1 ? What should change in the DCF analysis and why: P1-P3 ? Other important issues: P3-P4 ? Evaluation of each investment Criteria: P4-P5 ? Ultimate recommendation and forward looking: P5-P6 ? Revised DCF analysis: Appendix Changes to capital project?

Since reviewing and discussing the proposal, several things have come to light and we are requesting some changes to the DCF analysis to include some potential solutions. First, it is agreed that the price for depreciation to the transport division's equipment should not be included in the proposal. The transport division is responsible for overseeing movement of all raw, intermediate, and finished materials throughout the company and if the depreciation cost is included in the analysis it would artificially inflate profit for that division.

The Transport Division and Intermediate Chemicals Group also have its own vice presidents whose pay incentives are based on the performance of the division. In this case, if the cost of depreciation for the transport cars were included in the analysis it would inflate profitability and coincidentally raise their pay incentive. Secondly, the proposal of this project is to increase production of Polypropylene and modifying the Merseyside plant would certainly increase production but there are several other factors to be considered in this project.)45 shutdown and the loss of sales 2) Request to include EPC plant modification with the proposal. 3)Cannibalization of

Rotterdam plant due to increased efficiency and possible lower production costs. Although there may be many solutions to this problem, we are proposing a possible solution that could alleviate most of the problems, but we would need a new DCF analysis to include the modifications to the proposal. It seems that since the EPC plant is only marginally productive and could possibly be shut down due to lack of profitability if not renovated.

We suggest that we start the analysis process to get some ideas on the cost of renovating the EPC plant to start producing Polypropylene. This would also increase polypropylene production and possibly alleviate the 45 day shut down that is required in the original proposal. Also, it alleviates potential for the EPC plant to lay off employees if a future abandonment of that project took place. EPC employees would be retained and retrained to produce polypropylene.

Also, there are some concerns that if Merseyside would undergo renovations and is able to produce polypropylene cheaper than our sister plant at Rotterdam, then cannibalization would occur. We are not so sure that since we are in different geographical locations and service different areas that cannibalization would occur. But, if a problem would arise and cannibalization is suspected, Victoria Chemicals can enact a price averaging policy for both plants.

Although Merseyside may be able to produce and sell polypropylene cheaper than Rotterdam if we average the sales price and have both plants sell at the same price it would alleviate this issue. Lastly, the 10% target rate of return that is used to configure the DCF analysis seems to be inclusionary of the inflation rate. The Treasury staff also thinks that it impounds a 3% long term inflation and therefore has a 7% zero inflation target rate of return. However, I don’t think we should use 13% discount rate to adjust for inflation rate.

The 10% target rate of return that was promoted in the latest edition of Victoria Chemicals capital-budgeting manual should include inflation and be the rate that we figure our capital budgeting projects at. If it weren’t to be configured with this rate, then it should be stated in the manual produced for capital budgeting. Concerns of the Transport Division Add GBP2 million Concerns of the ICG Sales and Marketing Department Cannibalization Concerns of the Assistant Plant Manager

Accept Griffin’s proposal and add initial cost GBP1 million and infinite cash inflow GBP25, 000. It is a real story. There are two four-star hotels in my hometown. They have almost same size, same price and similar location. One is more profitable than another, however. The manager of that hotel told me the reason which was very impressive. The biggest reason is that his hotel has more entertainment facilities. For example, it has bowling alley for sports lovers, maze for children and video game for teenagers.

To my surprise, all of them operate at net loss every year, which means the net present value of each facility is negative. The manager said, “ It sounds stupid that we accept the project with negative NPV. Our biggest competitor, another hotel in the town, is not willing to do such stupid things. However, when we are doing so, we get good word-or-mouth. Customers are able to find everything they need in our hotel. Imagine that when a company has customers or business partners, which hotel they will choose.

They have no idea about customers or business partners' interest and habit. All they need is to find a hotel which has everything they might need. " Therefore, Griffin's proposal should be accepted. Two main reasons: 1. Capture customers. Build good relationship with them. Some of them might purchase our other product 2. Be ready to exploit the EPC market when the recession ends Concerns of the Treasury staff 13% discount rate Other Important Issue Strength and weakness of the different investment Ultimate recommendation and forward looking