

Diamond chemicals plc (a) essay sample essay



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Diamond Chemicals is a big worldwide chemicals manufacturer with two mills in Liverpool England and Rotterdam Holland. Both of their works were built in 1967 with one-year end product of 250. 000 metric dozens polypropene. Compare with low-priced manufacturer.

the production cost per ton is 1. 09 which is a small spot high than rivals (see Exhibition 1) . With the diminution EPS from ? 60 in 1999 to ? 30 in 2000 and worldwide economic lag. the accountant of works director of Merseyside (Liverpool) . Frank Greystock.

convey a betterment undertaking in order to do works more efficiency. more end product and salvage more energy. Frank proposed an outgo of ? 9 million to reconstitute and apologize the polypropene production line at Merseyside works. This undertaking would be in the engineering-efficiency class with 17. 500 dozens production increasing and following investing standards: 1) Average one-year add-on to EPS = ? 0.

018. 2) Payback period = 3. 6 old ages. 3) NPV=? 9 million. 4) IRR= 25.

9 % . PROBLEM STATEMENT: This undertaking will take 45 years to close down Merseyside works and their clients have to purchase from rivals since Rotterdam's works was running near capacity. After betterment. the end product will increase 7 % and gross border will increase from 11. 5 % to 12.

5 % with a low energy demand. But there are four major issues from inside and outside Merseyside works: Presently the conveyance division could do this allotment out of extra capacity. but making so would speed up from 2005 to 2003 the demand to buy new turn overing stock to back up the

growing. The manager of gross revenues argues that the industry is in a downswing and it looks like an glut is in the plants.

That means they have to switch capacity off from Rotterdam toward Merseyside. It is non truly a addition for whole company. Marketing frailty president is less disbelieving and believes the market would resuscitate and necessitate more merchandises at that clip. The helper program director suggests adding more EPC betterment undertaking (cost ? 1 million) to prolong the negative NPV of EPC undertaking.

Otherwise this EPC undertaking may hold to go out in three old ages. The exchequer staff thinks this impounds a long-run rising prices outlook of 3 per centum per twelvemonth. Analysis AND Recommendation: Morris drafted a Discount Cash Flow analysis for this undertaking with above informations (see Exhibition 2) ; nevertheless it might be revised harmonizing to current external environment and internal factors. EXHIBITION 3 nowadays a new price reduction hard currency flow analysis for the Merseyside undertaking if we consider following factors.

Following is the analysis for four major issues list above. The conveyance division needs to buy a new armored combat vehicle auto two old ages earlier than original program (from 2005 to 2003) . Because this undertaking accelerates the buying of armored combat vehicle autos. it is necessary to affect the depreciation displacement to an earlier day of the month.

So two twelvemonth depreciation should be included in DCF. In another words. the entire depreciation = New depreciation of works + New

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depreciation of armored combat vehicle autos (from 2004) - original
depreciation of new armored combat vehicle autos (from 2006) . [_refer
line 19-21 of Exhibition 3_]Here the armored combat vehicle auto needs to
buy in 2003 alternatively of 2005.

Compare with original fiscal statement (without this undertaking) . 2003 will
lose more 2 million and 2005 will add more 2 million. In order to do the
informations more accurate. the hard currency flow in 2003 will be deducted
2 million lb because of buying. and added this buying (2 million lb) back to
our hard currency flow in 2005.

[_refer line 31 of Exhibition 3_]This undertaking will cannibalise another
works (Rotterdam works) . The industry is in a downswing and it looks like
an glut is in the plants. so the Merseyside undertaking will likely hold to
switch capacity off from Rotterdam toward Merseyside in order to travel the
added volume. It besides shows from Exhibition 3 that from 2002.

the addition end product (17. 500 dozenns) of Merseyside may do doomed
of Rotterdam end product. So the incremental gross net income demand to
be deducted by the doomed of Rotterdam end product. [_refer line 12-15 of
Exhibition 3_] But as all known.

it is difficult to foretell. Possibly the industry may travel up after several old
ages (as selling frailty president said) . At that clip. the addition of end
product will profit the company.

Here we draft this undertaking DCF with a conservative premise to see
whether this undertaking is value to put. The EPC undertaking. originated by

helper works director. should be a separate undertaking in the Merseyside's capital budgeting.

Although the EPC production is a portion of end product from Merseyside works. this undertaking we are speaking about is to reconstitute and apologize the polypropene production line. There is no dependence between them. We understand this EPC undertaking might be really of import for the company. But it is needed to suggest another separate capital budgeting for blessing.

As Gowan said. " The Treasury staff thinks this impounds a long-run rising prices outlook of 3 per centum per year" . To maintain the gross border. the company may necessitate increase gross revenues 3 % per twelvemonth.

As we all known. in most instances. the cost of goods sold will increase consequently with rising prices. If the company continues maintaining original gross revenues. it means the gross will worsen. So in DCF tabular array.

we add 3 % addition for both before and after Merseyside undertaking. The impact points from the tabular array are: new gross revenues [_line 4 of exhibition 3_] . old gross revenues [_line 9 of exhibition 3_] . and overhead [_line 23 of exhibition 3_] .

Furthermore. there is a possible hazard that the works will be closed for 45 years. All the clients would purchase from rivals since Rotterdam works was running near capacity. Greystock believe the loss of clients will non be lasting. But really.

it is difficult to calculate that the client will come back to purchase your merchandise because the industry is in a downswing with an glut in the plants. So the company may lose some of client if they feel it is good from rivals. Besides this undertaking will cut down the cost of goods and salvage more energy in the hereafter. From the history informations [_refer exhibition 1_] . the newer works generate lower production cost per ton.

Once the industry recovery sometime in the hereafter. the new works will hold more competitory strength with lower cost of goods and higher end product. Decision: From EXHIBITION 3. we re-calculate the hard currency flow for the Merseyside undertaking with the premise on new depreciation of conveyance. cannibalization of other works. and 3 % rising prices per twelvemonth.

The consequences of cardinal finicky factors are: Net present value = ? 5. 22 million
Internal rate of return = 20. 31 %
Payback period = 4. 51 old ages
Average one-year add-on to EPS = ? 0.

020From above informations. the Merseyside undertaking met all four investing standards. The undertaking is deserving for Diamond Chemicals.

Exhibit 1 COMPARATIVE INFORMATION ON THE SEVEN LARGEST
POLYPROPYLENE PLANTS IN EUROPE