

# Victoria chemical plc (a) essay sample

Economics



Victoria Chemicals, a major company in the chemical industry, was the number one producer of polypropylene, a polymer used in various everyday items. Victoria Chemicals at the end of 2007 was in a financial slump and was under pressure to improve their financial performance. Due to this financial slump, Lucy Morris, the Plant Manager at Merseyside Works, proposed a GBP12 million project to help modernize the production line of polypropylene by remodeling and relocating tank-car unloading areas to streamline the process, refurbishing polymerization tanks to achieve higher pressures and throughput, and renovating the plant to increase energy savings and extrusion throughput. The predicted benefits of this project are there would be a lower energy requirement that equates to 1.25% of sales, a 7% increase in manufacturing throughput, and an increase in gross profit margin from 11.5% to 12.5%. There were some concerns over the project as well. The Transport Division projected they would need to spend GBP2 million with the project, and it should be included with the outlay of the project. The marketing department believed that this project would cause the Merseyside plant to cannibalize sales of the Rotterdam plant. The Treasury Staff believed that a hurdle rate of 7% should be used instead of 10%. The Assistant Manager believed that the production line of EPC, a product Victoria was the leading supplier, should be renovated as well.

#### Question & answer

1. What changes, if any, should Lucy Morris ask Frank Greystock make in his discounted cash flow (DCF) analysis? Why? What should Morris prepared to say to the Transport Division, the director of sales, her assistant plant manager, and the analyst from the Treasury Staff? We think the best way

is to exclude sunk cost, change the depreciation into straight line, use the discount rate that excluded with the inflation rate, deducted the sales with sale cannibalization, and included opportunity cost of purchasing rolling stock. It will decrease the IRR. If we excluded the sunk cost, the IRR will decrease. Cost of tank cars should be included in the initial outlay of the Merseyside Works program, rather than in the book of transport division. Demand for the product is below VC is supplying. For the director of sales, transfer capacity away from Rotterdam toward Merseyside. Produce products at lower cost. Analyst from Treasury Staff. 10% hurdle rate excludes inflation rate. 3% inflation rate. So changed it into 7%, the discount rate. The IRR > 10% and NPV is positive.

2. How attractive is the Merseyside project? By what criteria? This project is very attractive especially the EPS increase. EPS is one of the most sensitive factors for the investors. The increase in EPS of 0.022 doesn't look that much but, given that the current number of outstanding shares is 92,891,240 and if we trace it back to the addition net profit, we get 2,043,607.28. Given that the estimated Gross profit for 2008 using current operation method is about 19.41 million dollars, the additional net profit is about occupying more than 10 percent of it. What is more, the 2 million dollars are promised every year not for certain period. Thus, considering the EPS increase, this project is attractive to the firm and the investors, too.

3. Should Morris continue to promote the project for funding? Morris should continue to promote the project for funding. With the new technology, the organization is likely to benefit from the returns. The Merseyside Plant is aging, it is losing its competitiveness relative to some of its industry peers.

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Merseyside should modernize. If the enterprise continues to use labor-intensive production techniques and antiquated technology, it will find it hard to adapt to the change related to the consumer needs. Efficiency will be seriously troubled and affect the quality of output. It should modernize since it is likely to introduce efficiency and result in the long run gain in the organization. Our calculations also show that the Net Present Value of this project is positive. Therefore, this project should be accepted if its Net Present Value is positive.