SEMESTER 1 ASSESSMENT

INTERNATIONAL CORPORATE FINANCE: 6310BUSBS & 6106LBSBW

COURSEWORK

UK Oil Plc

Company Background

UK Oil Plc are involved in upstream, oil exploration and production in the North Sea, United Kingdom.

Future Strategy

The Board of UK Oil are considering their future strategy.

Despite the challenges facing the sector, (declining oil reserves, volatile oil prices, pressure from US shale producers, volatile demand, coupled with a high cost base and environmental risks), the Board feel they must invest in order to sustain and grow the business.

The Board are willing to invest up to a maximum of £350 million and require your financial evaluation of two alternative strategies, together with your recommendation:

1. The Development & Operation of a New Oil Platform in the North Sea costing approximately £315 million
2. The Merger or Acquisition of an Oil Refinery (Euro Refinery) located in Ireland costing approximately £320 million
3. The Development & Operation of a New Oil Platform in the North Sea costing approximately £315 million

**Schedule of Activities, Immediate Predecessor & Duration (O = Optimistic, M = Most Likely, P = Pessimistic)**

|  |  |  |
| --- | --- | --- |
| **Activity**  | **Immediate Predecessors** | **Duration (months)** |
| **O** | **M** | **P** |
| A: Geological Study | Completed | 12 |
| B: Technical Evaluation | A | 2 | 3 | 10 |
| C: Financial Evaluation | A | 3 |
| D: Board Consideration | B & C | 1 | 3 | 4 |
| E: Safety Report | D | 1 | 4 | 11 |
| F: Hire & Training of Labour  | D | 1 | 3 | 4 |
| G: Site Preparation  | E & F | 3 | 5 | 6 |
| H: Delivery & Construction of the Oil Platform  | E & G | 2 | 6 | 8 |
| I: Delivery of Material | G | 1 | 3 | 5 |
| J: Pre Sale Drilling & Production | H & I | 1 | 2 | 3 |
| K: Sales & On-going Drilling & Production | J | On-going |

**Activity A: Geological Studies**

Geological studies lasting 12 months have just been completed at a cost of £10 million and the project is now entering the Technical & Financial Evaluation stage.

**Activity B: Technical Evaluation**

Production & Chemical Engineers will be asked to evaluate the feasibility of the project over the next 3 months

**Activity C: Financial Evaluation**

Your task is to present a Financial Evaluation & Recommendations to the Board in 3 months’ time to assist in their decision making.

**Activity D: Board Consideration**

The Board will consider both the Technical & Financial Evaluations before making their decision whether or not to proceed with the project.

**Activity E: Safety Report**

A shortage of safety engineers in the sector may well prove critical to the timely start of the project, though this could be solved by moving suitably qualified staff from other activities, though it is uncertain whether this action would then delay the project.

**Activity F: Hire & Training of Labour & Activity G: Site Preparation**

Associated costs are include in “Other Costs” detailed below

**Activity H: Delivery & Construction of the Oil Platform including Drills, Pumps, Pipelines etc**



Two suppliers have been identified, British Oil Machinery who have quoted £315,000,000 and Munchen Machinery Germany who have quoted of €350,000,000.

Details of the contract have yet to be agreed but UK Oil will clearly need to reduce the risks associated with the tender and performance of the contract, particularly as the contractor may require an advanced payment of 10%.

**Activity I: Material**

In order to operate the site, emulsifiers to aid the separation of oil and water and corrosion inhibitors to protect the pipelines would be required. In total 100,000 tons of material would be required each year of the project

Three quotations have been received from potential suppliers and prices are expected to increase in line with the national inflation rate, throughout the life of the project:

**Supplier Price (ton) Payment Terms**

Russia Rub 29000 CFR Ust Luga

 Open Account - settlement 2 months after

 shipment

U.S.A US$ 425 CFR Dover

D/A – Bill of Exchange payable 1 month after

shipment

Collection charges of 0.25% are payable by the buyer.

Netherlands € 370 CIF Dover

Confirmed Irrevocable Documentary Credit – payment 3 months after shipment.

Documentary credit charges of 0.75% are payable

by the buyer.

**Activity J: Drilling & Production Costs**

Annual Drilling & Production Costs for this project are expected to be in line with previous ten projects detailed below, though drilling rates could be affected by oil prices:

 **Previous Project Output (Barrels) Costs**

 1 2,000,000 £50,000,000

 2 2,500,000 £65,000,000

 3 2,300,000 £54,000,000

 4 2,600,000 £62,800,000

 5 3,000,000 £70,000,000

 6 2,750,000 £66,100,000

 7 2,900,000 £67,000.000

 8 3,100,000 £69,000,000

 9 1,800,000 £42,500,000

 10 1,750,000 £40,200,000

**Activity K: Sales**

The project is expected to increase productivity in the North Sea enabling the company to secure an additional 6,500,000 barrels per year, for the next 25 years.

The additional crude oil will be sold to various oil refineries including a number of new customers in Europe.

**All Other Costs**

All other costs associated with the project (Indirect Labour, Administration, Marketing etc) are estimated to be £10,000,000 per year, increasing throughout the project in line with UK inflation rates.

Finance

The Method of Finance has yet to be agreed and the Board seek your advice

1. The Merger or Acquisition of an Oil Refinery (Euro Refinery Plc.) located in Ireland approximately £320 million

A merger may be possible via a 1 for 1 Share Exchange.

An Acquisition(s) may be financed by:

* a Rights Issue, or
* Issuing Debt

The latest financial statement shows:

***Statement of Financial Position/Balance Sheet of Euro Refinery Plc as at 31.12.2019***

 ***€’000 €’000***

***Non Current*** – at cost 217,000

Accumulated depreciation (26,000)

  **191,000**

***Current Assets***

Inventory/Stock 78,000

Accounts Receivable/Debtors 46,000

Prepayments 5,000

 **129,000**

***Current Liabilities***

Accounts Payable/Creditors 27,000

Dividends 8,000

Overdraft 12,000

 **47,000** **82,000**

 **273,000**

***Equity***

Share Capital – $1 Ordinary Shares 250,000

Retained Profits 23,000

 **273,000**

Annual Earnings for the year ending 31st December 2019: € 23,000,000

Current Market Price per share €1.50

In addition to the normal benefits and risks of mergers and acquisitions, this deal will hopefully secure the following additional annual sales/costs, *(i.e. additional to existing sales):*

* UK Oil Plc: 1,000,000 m/b of Crude Oil to Euro Refinery Plc.
* Euro Refinery Plc: Sales of Gasoline and Heating Oil using a 3-2-1 Crack Spread
* Variable Costs:
	+ UK Oil – as per previous production costs
	+ Euro Refinery Plc - $5pb
* Fixed Costs p.a.
	+ UK Oil – £5 million
	+ Euro Refinery Plc - €5 million

The Irish Government, (where the company is registered) may also be willing allow a 5 year tax break, resulting in 0% Corporation Tax.

In order to manage the Group finances the Board may wish to establish a Group Treasury Department in either the UK or Ireland, to operate as either a cost centre or a profit centre. Management Fees of £1,500,000 or € equivalent would then be paid to/received by the Treasury Department.