Case Study on HPCL

The Hindustan Petroleum Corporation Limited (HPCL) has a retail outlet of petrol, diesel and petroleum products. Presently, it has two pumps exclusively for petrol and diesel. The pumps have a useful life of 10 years with no salvage value as the underground tank will be completely corroded and unfit for reuse. The UPL sells petrol and diesel @ Rs 23 and Rs 10 per litre respectively. The existing annual sale of petrol is 5 lakh litres and diesel 2 lakh litres. Its earnings are 4 per cent as commission on sales. Due to a manifold increase in traffic, the existing pumps are not able to meet the demand during peak hours. The HPCL is considering installation of additional pumps for diesel and petrol at a cost of Rs 10,00,000 together with additional working capital of Rs 5,00,000.

The additional sales of petrol and diesel are expected to be 2 lakh litres and 1 lakh liters per annum respectively. As a result of the installation of the new pump, the operating cost would increase by Rs 24,000 annually by way of salary of the pump operator. Other yearly associated additional costs are estimated to be: insurance @ 1 per cent of the cost of the pump, maintenance cost Rs 12,000 and power costs Rs 13,000. Hindustan Petroleum Corporation Limited pays 35 per cent on tax on its income. Depreciation will be on straight line basis and the same is allowed for tax purposes.

Question:

The management of HPCL seeks your advice on the financial viability of the expansion proposal. Prepare a report for its consideration, assuming 12 per cent required rate of return. (Using NPV method)

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