

The Dilemma of Sailing Beauty Limited

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Suggested Solution to Case Study

(a) The dilemma before the Chairman of SBL is whether to make further investment of US\$13.75 million (25% of the subordinated loan amount of US\$55 million) or to just contribute additional US\$ 5 million (the remaining equity contribution). However, if the Chairman does not contribute the loan amount, the entire Joint Venture (JV) may be in jeopardy. If he contributes the additional US\$13.75 million, there is also no guarantee that the venture would earn sufficient profit to justify investment. The other JV partner (MOL) is, however, not that pessimistic about the future prospect of the JV and is willing to pay 75% of the loan amount of US\$55 million.

As an extreme step, the Chairman of SBL can also explore the possibility of selling its entire equity stake to MOL. But as the fact of the case suggests that scenario is unlikely to happen.

(b) Hence, the task of the Director Finance of SBL is to estimate the IRR of SBL's investment under two scenarios:

Scenario I: SBL makes the additional investment of US\$18.75 million (including equity contribution of US\$5 million);

Scenario II: SBL just invests its equity contribution of US\$ 5 million;

Scenario III: SBL does not make any additional investment.

If Scenario I is followed, the Consortium of Banks would not invoke the force majeure clause and hence the JV can take delivery of the vessel in due time and try to charter out the vessel right from the beginning of 2002. However, since the JV has an agreement with KPC to make the vessel available to the latter as soon as the Phase II plants are ready, the JV cannot take the risk of chartering out the vessel for a long period of time. The problem with short-term charter of the vessel is that the hire charge would be much lower. No user of LNG would like to pay long-term higher charges for short-term vessel contracts.

If Scenario II is followed, two situations may emerge: either MOL takes the burden of paying the entire loan amount of US\$55 million, or the lenders invoke the force majeure clause. In the first situation, MOL may like to force SBL to reduce its equity stake as compensation of not paying its share of the loan amount. In the second situation, the JV would close down and SBL would lose the entire investment of US\$13 million.

If Scenario III is followed there is a high likelihood that SBL would lose the entire US\$ 8 million paid so far in the JV. A loss of US\$8 million with certainty would be an inferior choice compared to some probability of surviving the JV and earning some returns. Thus the choice before the Chairman of SBL would be restricted to first two cases, psychologically speaking.

The author is a professor in the Indian Institute of Management, Calcutta.

A case study relevant for the students of Final course was included in the June, 2005 issue of the Newsletter.

Responses were invited from the students and reviewed.

Cash prize of Rs. 1000 for submitting best reply is being awarded to Dhaval Shah.

Our heartiest Congratulations



(c) The estimation of project cost:

Year	Capex (payment to shipyard + other capex)	Interest during construction (IDC)	Project cost	Cumulative project cost
1999	21339	1539	22878	22878
2000	73774	4252	78026	100904
2001	134887	8899	143786	244690

(d) Options before the banker:

- Work on the restructured option.
- Trigger early repayment.
- Take possession of the vessel and sell it off.

(e) (Figures in US\$000)

Year	Annual hire charges	Operating costs
2002	26775	4641
2003	26775	4780
2004	24990	4924
2005	24990	5071
2006	24990	5223

(f) However, the required hurdle rate of 16% IRR (with depreciation benefit) is a far cry in this case and the computations (not shown here- see the excel file) show that the IRR would be around 4%. The estimations of IRR also show that it might be better for SBL to follow Scenario II and thereby expect an IRR of close to 5%. But there are other strategic considerations to be taken into account before SBL can finally decide about a particular path. One possibility could be that if MOL refuses to bear 100% of the loan burden, the JV may fail and then SBL may lose US\$13 million (as against US\$8 million in Scenario I). But if MOL agrees to contribute the entire subordinated loan, it would be better for SBL to just contribute the remaining portion of equity. In any case, SBL should not expect a return of 16% IRR from this venture.

Loan Repayment

Year	Op. O/S Loan	Interest	Cl. O/S Loan	Avg. loan	Principal
1999	15629	1539.46	15629	15629	
2000	15629	4251.70	70700	43164.5	

SCENARIO IV: THE LOAN OF US\$55 MILLION IS A SUBORDINATED LOAN WITHOUT ANY INTEREST HIRE CHARGES \$75000 PER DAY FOR FIRST TWO YEARS AND \$70000 THEREAFTER

Calculations are in US\$000

Year	Capex	Hire_Ch	Op_Cost	Net_Hire	DEPN	Interest	Proj.cost	Profit	Cumloss	Tax	PAT	CFAT	Repaym	Sub-loan	CF For Eq.	SBL's IRR	SBL's IRR (Sunk)
1999	21339					1539.46	22878.46	-1814.70				-22878.5				-8000	
2000	73774					4251.70	78025.70	-680.05	-1814.7	0	-1814.7	-78025.7				-18750	-18750
2001	134887	26775	4641	22134	13384.58	8899.48	143786.48	-1374.61	-2494.75			22134	5500.00	0.00	6069.88	0	0
2002		26775	4780.23	21994.77	12652.44	10022.38		-326.34	-3869.36	0	-680.046	21994.77	5500.00	0.00	6472.40	0	0
2003		24990	4923.637	20066.36	11960.35	9480.63		-326.34	-4195.71	0	-1374.61	20066.36	5500.00	0.00	5085.74	0	0
2004		24990	5071.346	19918.65	11306.12	8938.88		681.71		0	-326.342	19918.65	5500.00	0.00	5479.78	0	0
2005		24990	5223.486	19766.51	10687.68	8397.13		1651.37	-1862.62	0.00	681.712	19766.51	5500.00	0.00	5869.39	251.44	251.436
2006		24990	5380.191	19609.81	10103.06	7855.38		2584.35		0.00	1651.373	19609.81	5500.00	0.00	6254.43	1250.89	1250.887
2007		24990	5541.597	19448.4	9550.42	7313.63		3482.27		252.61	2331.75	19195.8	5500.00	2750.00	3632.17	726.43	726.4343
2008		24990	5707.845	19282.16	9028.02	6771.88		4346.61		1218.79	2263.47	18063.36	5500.00	2750.00	3041.49	608.30	608.2975
2009		24990	5879.08	19110.92	8534.18	6230.13		5178.81		1521.31	2825.30	17589.61	5500.00	2750.00	3109.48	621.90	621.8961
2010		24990	6055.452	18934.55	8067.36	5688.38		5980.18		1812.58	3366.23	17121.96	5500.00	2750.00	3183.59	636.72	636.7178
2011		24990	6237.116	18752.88	7626.08	5146.63		7495.32		2093.06	3887.12	16659.82	5500.00	2750.00	3263.20	652.64	652.6392
2012		24990	6424.229	18565.77	7208.93	4604.88		8211.32		2363.19	4388.78	16202.58	5500.00	2750.00	3347.71	669.54	669.5416
2013		24990	6616.956	18373.04	6814.60	4063.13		9585.22		2623.36	4871.96	15749.68	5500.00	2750.00	3436.56	687.31	687.3117
2014		24990	6815.465	18174.54	6441.84	3521.38		10204.93		2873.96	5337.36	15300.57	5500.00	2750.00	3529.20	705.84	705.8399
2015		24990	7019.929	17970.07	6089.48	2979.63		10820.90		3115.34	5785.63	14854.73	5500.00	2750.00	3625.11	725.02	725.0213
2016		24990	7230.527	17759.47	5756.38	2437.88		11413.90		3347.83	6217.39	14411.65	5500.00	2750.00	3723.77	744.75	744.7544
2017		24990	7447.443	17542.56	5441.51	1896.13		11984.59		3571.72	6633.20	13970.83	5500.00	2750.00	3824.71	764.94	764.9417
2018		24990	7670.866	17319.13	5143.86	1354.38		12248.97		3787.32	7033.59	13531.82	5500.00	2750.00	3927.44	785.49	785.4887
2019		24990	7900.992	17089.01	4862.49	812.63		12160.24		3994.86	7419.03	13094.14	5500.00	2750.00	4031.52	806.30	806.304
2020		24990	8138.022	16851.98	4596.51	270.88		12126.62		4194.61	7789.99	12657.37	5500.00	2750.00	4136.50	2087.30	2087.299
2021		24990	8382.162	16607.84	4345.08			12248.97		4291.97	7970.79	12315.87	5500.00	2750.00	9565.87	1913.17	1913.175
2022		24990	8633.627	16356.37	4107.40			12214.63		4287.14	7961.83	12069.23		2750.00	9319.23	1863.85	1863.847
2023		24990	8892.636	16097.36	3882.73			12160.24		4275.12	7939.51	11822.24		2750.00	9072.24	1814.45	1814.448
2024		24990	9159.415	15830.59	3670.34					4256.08	7904.16	11574.50		2750.00	8824.50	1764.90	1764.9
2025		24990	9434.197	15555.8	3429.19					4244.32	7882.30	71311.49		5500.00	65811.49	13162.30	13162.3
2026	60000											5.34%				1.09%	2.99%

