

PROGRESS TEST 2 SOLUTION

Briefing Paper

To: Board of Directors

Financial & Non-financial issues to consider for the contract to build the road in Betal.

The contract to build the road in Betal seems to be the type of contract that CC is looking forward to as it will give them the profitability, cash flow and opportunity to expand further into Betal. However, Betal government has emphasize on the need to complete the project within a time frame and cost and these are important issues that CC must consider.

Below is the summary of the financial and non-financial issues that must be consider when evaluating the contract to build the road in Betal.

Financial issues

We have set a minimum profit margin of 8% for most projects, the Betal project has a forecast profit of \$2 billion, this works out to approximately 9.5% margin. Thus, on paper the project is acceptable as it meets the minimum requirement.

Although CC has been successful in Omegland, they were not so successful outside of Omegland. Their venture on a road project in Alpha were loss making for the first four years. Thus, the shareholders of CC will be cautious about the project in Betal. Although the projected financial results are positive, I'm sure the same is presented to them for Alpha project.

CC has just announced their first increase in dividend in three years, it is imperative that they maintain the dividend in the coming years. To maintain the dividend, there is a need to ensure profitability and availability of cash flow. The project involved a huge outlay, thus there may be implication on CC cash flow if the progress payment has a delay.

The size of the project is twice the largest project ever handled by CC. The largest project handled by CC was \$10 billion in Lambdahasa, but the project in Betal was \$20b. This present additional risk to CC in terms of resource availability and capability to handle the project.

There is a need for CC to maintain liquidity and meet loan repayment and covenant, CC needs to maintain a capital structure which balances equity and debt. Thus, the project may result in a significant increase in the debt of CC and ultimately affecting the loan covenant. Further there is a loan due for repayment in the next three years that CC intend to replace with equivalent funding, thus the project may affect their ability to repay.

Non-Financial issues

The risk manager has highlighted that any failure of projects to meet time, budget and quality requirements represents a fundamental threat to CC's business. Thus, CC is developing SiteSmart to improve on their project management. Unfortunately, the initiative is not ready until two years -time. Thus, accepting the project present a risk factor to CC without the completion of the SiteSmart initiative.

CC's previous projects have taken place in the flat countries of Omegland and Alpha, however this project involved constructing road through mountainous area. This will pose new challenge to CC that they may not have any previous experience.

CC will need to consider the resource availability in Betal in order to complete the project within the tight deadline. As they were not previously in Betal, there is a need for CC to source for new supplier and recruit employees for the project.

The project will need the support of the local community in Betal as they will be engaged as workers of the project. CC will need to ensure that they are able to manage the difference in culture.

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Difficulties to meet the Transport Minister requirement

Betal government expect the road to enhance the Eastern region's economic development. However, this is beyond the control of CC as the road can only promise the connectivity but whether this will lead to economic development depends on other factors as well.

The road is expected to reduce delays caused by flooding and reduce travelling time by almost half. This target set is another challenge, first floods are due to two factors poor drainage and weather condition. CC should be expected to improve the drainage since it was mentioned by the transport minister. However, CC will have no control over the weather, thus if there is continuous and heavy rain at times this cannot be prevented.

If CC is awarded the contract it shows that they are the lowest bidder for the project. Further the minister expects the project to be completed efficiently within a short time frame. This will be a challenge because to complete the project fast there is a need to incur more man hours thus cost will increase.

CC is also expected to minimize the environmental footprint during the construction. However, in order to be cost conscious, CC may choose route that easier to construct and less costly and this may be at the expense of the natural habitat. Further, the requirement to complete it fast may also cause more disruption