

CITY BEAUTIFUL TRAVELS

Sunil Mehra, a resident of Chandigarh, is an unemployed commerce graduate, aged 26 years. He does have some experience of working as an assistant in a tourist bus service. He is now thinking of floating a tourist bus service himself. The project requires an estimated cost of Rs 3,00,000 i.e. Rs 2,00,000 as cost of bus chassis and Rs 1,00,000 as cost of deluxe body with 50 seats. Sunil's father has promised him to contribute Rs 1,00,000 as equity capital on his behalf. His father would like him to earn at least an after-tax return of 13 per cent on equity capital. The remaining amount of Rs 2,00,000 will be borrowed by him from a nationalized bank.

PROJECT IDEA

Chandigarh, where Sunil lives, is situated at about 250 km Northwest of Delhi on the National Highway No. 1, which runs between Delhi to Wagah International Border. The city is so beautifully planned by Mr LeCarbusier, a well-known French architect, that it is known as the City Beautiful. Chandigarh is surrounded by historical places as well as good picnic spots and hill stations. To its north are Shimla and the Pinjore gardens where the Pandavas were said to have lived during their exile. To the north west is Anandpur Sahib where the ninth Sikh Guru, Guru Teg Bahadur, was cremated, and also the Bhakra Nangal Dam. To its west are industrial towns of Ludhiana and Jullunder, and also the famous Golden Temple at Amritsar; and beyond that is the Wagah International Border where the Sounding of the Last Post is an attraction for tourists. To the south of Chandigarh is the famous old city of Patiala with its wonderful museum of old weapons, and to its east is the popular Karna Lake which is a great picnic spot.

With all these attractions in and around Chandigarh, there is a very good potential to run a tourist bus service. At present there is hardly any good tourist bus service. Train services are available, but they are time-consuming as well as inconvenient.

All this prompted Sunil Mehra to think of starting a tourist bus service based in Chandigarh. He has done some market survey. He is convinced that there are no good services at Chandigarh to cater to the touring needs of the upper class people, who are prepared to pay for a good tourist service, if it is available. He has also contacted some of the hotels in and around Chandigarh and was assured support if he could run a good bus service.

ESTIMATES OF THE PROJECT'S PROFITABILITY AND CASH FLOWS

As stated earlier, the initial cost of the project is estimated as Rs 3,00,000. On the basis of the project's profitability and cash flow estimates, a nationalized bank has sanctioned a five-year term loan of Rs 2,00,000 at 15 per cent per annum (the bank's letter of approval is given in Annexure I).

Exhibits I, II and III respectively give the estimates of operating costs, and profitability. In preparing the estimates, Sunil has assumed that in spite of good publicity and hard work, it will not be possible for him to operate the bus for more than 70 per cent of its occupancy. With sustained efforts and good contacts, the occupancy is expected to increase to 80 per cent in the second year and to 90 per cent in the subsequent year. He hopes to run the bus for 25 days in a month. Further, he expects the bus to have a useful life of five years, after which it could be sold for Rs 1,00,000. Depreciation will be charged at 30 per cent per year on the vehicle's written down value.

Fuel cost is the major item of variable cost. It is expected to increase at 10 per cent per year due to change in diesel price. Repairs are semi/fixed costs (they have been assumed as variable cost in Exhibit I); they are expected to increase with increased occupancy over the years. Tax, insurance and rent are assumed to remain constant because of the reduction in insurance premium owing to depreciated value of the vehicle, offset by increase in road tax and rent. Miscellaneous expenses for office rent and furniture include Rs 5,000 per year.

Revenue is calculated assuming Rs 350 per running km. In spite of the increase in the fuel cost, the rate is assumed to remain constant during the project's life because of the expected competition from other bus operators. Bank interest is payable at 15 per cent per year, taking into account the monthly repayments. It is estimated that Sunil will be paying tax approximately at 25 cent per annum. Exhibits II and III show the detailed estimates of the project's before-and-after-tax profitability. The project earns an average rate of return of 18.2 per cent before tax and a 13.6 per cent after tax—which is slightly higher than the minimum required rate of return on equity capital.

Sunil has also prepared estimates of net cash flows (Exhibit IV). His estimates show that after repaying the instalments of the term loan and allowing an average 13 per cent dividend on equity capital, he will have a total cash surplus of Rs 53,400 at the end of the project's life. This amount would be much more if the project's after-tax salvage value is also included.

ANNEXURE I

XYZ BANK

Ref: 1/XX

Branch: Chandigarh

4.1.19XX

Mr Sunil Mehra
 Proprietor,
 City Beautiful Travels,
 Chandigarh.

Dear Sir

With reference to your application for a vehicle loan dated 15.2.1984, we have the pleasure to inform you that we are sanctioning you a credit limit of Rs 2 lakh as per terms and conditions stated below. You may call on us during office hours to execute the necessary loan papers.

1. Nature of Facility	Other Secured Loan (Vehicles)
2. Amount of Loan	Rs 2,00,000 (Rupees Two Lakh only)
3. Interest	6 per cent above the Bank Rate with a minimum of 15 per cent p.a.
4. Security	One new deluxe bodied Ashok Leyland bus costing Rs 3 lakh.
5. Margin	35 per cent.
6. Repayment	Rs 4,000 (Rupees four thousand) per month.
7. Surety	Mr -----
8. Other conditions	The vehicle shall be insured for its full value with Bank clause and SRCC clause and the policy shall be handed over to the Bank. The Bank's lien shall be noted in the R.C. Book. Service Charges was Rs 50.

The Bank reserves to itself the right to cancel the above said limit and alter the conditions without assigning any reasons whatsoever.

Thanking you,

Yours sincerely.

(sd)

Exhibit I

CITY BEAUTIFUL TRAVELS
Estimate of Costs

(Rupees in thousand)

Year	Occupancy (per cent)	Variable Costs			Fixed Cost			
		Fuel Oil Grease	Repairs	Publicity and other expenses	Wages and Bonus	Tax Insurance and Rent	Depreciation	
	Rs	Rs	Rs	Rs	Rs	Rs	Rs	Rs
1	70	67.5	1.5	5.0	5.0	25.0	34.0	90.0
2	80	81.7	1.6	15.0	6.0	26.0	34.0	63.0
3	90	98.8	1.8	20.0	7.0	27.0	34.0	44.1
4	90	108.7	1.8	25.0	8.0	28.0	34.0	30.9
5	90	119.6	1.8	30.0	9.0	29.0	34.0	21.6

Exhibit II

CITY BEAUTIFUL TRAVELS
Estimate of Revenues, Costs and PBIT

(Rupees in thousand)

Year	Revenue	Variable	Fixed	Total	PBIT
	Rs	Rs	Rs	Rs	Rs
1	220.5	74.0	154.0	228.0	(7.5)
2	252.0	98.3	129.0	227.3	24.7
3	283.5	120.6	112.1	232.7	50.8
4	283.5	135.5	100.9	236.4	47.1
5	283.5	151.4	93.6	245.0	38.5

Exhibit III

CITY BEAUTIFUL TRAVELS
Estimate of Interest Tax and PAT

(Rupees in thousand)

Year (1)	PBIT (2)	Interest (3)	PBT (4) = (2) - (3)	Tax (5)	PAT (6) = (4) - (5)
	Rs	Rs	Rs	Rs	Rs
	(7.5)	25.8	(33.3)	-	(33.3)
2	24.7	19.2	5.5	-	5.5
3	50.8	12.0	38.8	2.6	36.2
4	47.1	4.8	42.3	10.6	31.7
5	38.5	0.2	38.3	9.6	28.7

Exhibit IV

CITY BEAUTIFUL TRAVELS
Estimate of Net Cash Flows

(Rupees in thousand)

Year (1)	PAT (2)	Depreciation (3)	(2)+(3) (4)	Loan Repayment (5)	Equity Dividend (6)	NCF (4)-(5)-(6) (7)	Cumulative NCF (8)
1	(33.3)	90.0	56.7	48.0	8.0	0.7	0.7
2	5.5	63.0	68.5	48.0	12.0	8.5	9.2
3	36.2	44.1	80.3	48.0	15.0	17.3	26.5
4	31.7	30.9	62.6	48.0	15.0	(0.4)	26.1
5	28.7	21.6	50.3	8.0	15.0	27.3	53.4