PetroMandarin Weighs its Global Cost of Capital

A Case Study in Multinational Energy Companies Considering their Sources and Cost of Funds
Stephen V. Arbogast, Executive Professor
C.T. Bauer College of Business, University of Houston

Abstract

How does life change when a state-owned energy company becomes a publicly listed multinational? For one thing, it typically improves its access to lower cost debt and equity capital. This should imply a lower cost of capital going forward, and a greater portfolio of economically viable projects. Such is not always the case, however. The move into foreign capital markets can be accompanied by confusion about both the correct cost of capital and the economics of future projects. This case, based on the listing of a Chinese oil company, offers such a situation.

The executives of PetroMandarin (PM) are struggling with different signals from their foreign and domestic stock listings. PM's local listing is showing a higher Price/Earnings ratio than its foreign listing. Some executives believe this suggests a lower cost of capital for PM, and thus a lower discount rate to be used when justifying new projects. PM's CFO faces a few difficulties. For one thing, he must decide if this interpretation is correct. Second, if the judgment is sound, he must explain why the decision to list shares abroad has not brought access to cheaper capital. He must also give guidance about how to use the cost of capital in future project economics. Here it is important determine whether today's situation is temporary or likely to endure. This will involve analyzing whether PM's stock price performance across global markets will converge over time.

Lastly, the CFO must decide how much PM's cost of capital matters, given the firm's continuing commitment to "social investment." The case contains information about PM's complex identity as a publicly listed state company. This includes a statement of future strategy (Attachment 3).

Students must stand in the CFO's shoes and attempt to answer these questions for the PM senior management. In the process, they will gain insight into the workings of state-owned energy competitors, including the fact that life for these companies has its own complications.

Late in the 1990's, China directed its three state oil companies, CNPC, Sinopec and CNOOC, to list shares of major subsidiaries on the Shanghai, Hong Kong, London and New York Stock Exchanges. The case author had some involvement in the Sinopec listing, as ExxonMobil purchased some of that firm's IPO shares.