equaliFi ACADEMY

CPF

CERTIFICATE IN PROJECT FINANCE

Session 1: Introduction to Project finance

Objectives of the Session

- To give a brief understanding about project financing.
- To understand the importance of project financing.
- Parties involved in project financing.
- Role of documentation in project financing.
- Risks involved in project financing.
- Mitigation techniques.

Introduction History

History of project financing:

Project financing techniques **date back to at least 1299 A.D.** when the **English Crown financed** the exploration and the development of the **Devon silver mines by repaying the Florentine merchant bank**, Frescobaldi, with output from the mines. The Italian bankers held a one-year lease and mining concession, i.e., they were entitled to as much silver as they could mine during the year. In this example, the chief characteristic of the project financing is the use of the project's output or assets to secure financing. Another form of project finance was used to **fund sailing ship voyages from Roman and Greek time until the 17^{th} century**. Investors would provide financing for **trading expeditions** on a voyage-by voyage basis. Upon return, the **cargo and ships would be liquidated** and the proceeds of the voyage split amongst investors. One of the Iranian examples could be IRAN MELI BANK

- Concept In 19^{th} Century, in London numerous Railway Projects were financed
- In 1980s, UK saw the greatest growth spurt in Project Financing, with Power Projects, Infrastructure Projects, Transportation Projects and Telecommunication Projects.

Definition

Project financing refers to the means of finance employed for meeting the cost of the project.

The means of finance refers to the long-term sources of finance used for meeting the cost of the project.

Sources of finance :

- Equity capital and preference capital
- Convertible and non-convertible debentures
- Terms loans
- Deferred credit
- Sales tax deferment and exemption
- Unsecured loans and deposits, etc.

History as a Guide in Financial Analysis: Project Finance versus Corporate Finance

Corporate Finance

- Analysis is founded on history and evaluation of how companies will evolve relative to the past.
- Financing is important but not necessarily the primary part of the evaluation.
- Successful companies expected to continue growing.
- Focus on earnings, ROIC, P/E ratios, EV/EBITDA ratios and Debt/EBITDA.

Project Finance

- Since there is no history a series of consulting and engineering studies must be evaluated.
- The bank assesses whether the project works (engineering report).
- Successful projects will pay of all debt from cash flow and cease to operate.
- Focus on cash flow. Equity IRR and DSCR.

Why Project Finance?

- Inability of the promoters to gather such a huge amount
- Sharing Risk of investment in large project with the Lenders
- A desire on the part of the sponsors not to consolidate the project's debt on to their own balance sheet.
- Sometimes the sponsor wants to insulate themselves from project debt and failure
- When a sponsor is investing in a project with others on a joint venture basis, it can be extremely difficult to agree a risk sharing basis for investment acceptable to all the co sponsors. In such a case, investing through a special purpose vehicle on a limited recourse basis can have significant attractions.
- Tax Advantage
- Government Support

Concept of Recourse

- The word ‘**Recourse**’ is commonly used in Project Finance. To understand this, we need to understand what is Non Recourse Project Finance.

- **Non Recourse Project Finance:**

- Non-recourse finance is a type of commercial lending that entitles the borrowers to repay only from the profits of the project the loan and not from any other assets of the borrower. ... In case of default, the lender may not seize any assets of the borrower beyond the collateral.

Key Sponsor Issues:

- Having settled on the structure of the project vehicle, it will then be necessary for the sponsors to settle down on the below mentioned points:
- Roles and responsibility of individual promoters
- Appointment of Advisors- both technical & Commercial/Legal
- Deciding on capitalization- how much capital to put in
- The dividend distribution policy of the promoters- when to take profit & how
- Making a flowchart and making management strategies
- Sale of shares of the promoters

Parties to Project Financing

- Project Company/Borrower
- Sponsor/Shareholders
- Third Party Equity Investors
- Banks
- Facility Agent- one of the lender appointed as facility agent in case of syndicated loans
- Technical Bank- A Bank appointed for technical aspects of project loan
- Insurance Company
- Multilateral and export Credit Agencies
- Construction Companies
- Operators- In case the project is not directly operated by the sponsor
- Experts- Legal, technical, valuers etc.
- Suppliers & Purchasers
- Host Government

Project Financing Documentation

- Documentations are extremely important in Project Financing to avoid future litigation and mitigate risks.

- <u>Documentation can be broadly grouped as followed:</u>

1. Shareholder/Sponsor Agreement
2. Loan and Security Documents
3. Project Documents

1.Shareholder/Sponsor Agreement

- Pre Development Agreements-An agreement by two or more companies who has entered into an agreement to undergo a feasibility study for the project

- Joint Venture Agreement-In case an SPV is formed by two parties then they make a JV agreement to deal with items like injection of share capital, funding, voting requirements, resolution of disputes, dividend policy, management of SPV, change in shareholding etc.

- Sponsor/Shareholder support agreement- An agreement made by shareholders and SPV company for the performance and maintenance and other details of the project

2. Loan & Security Documents:

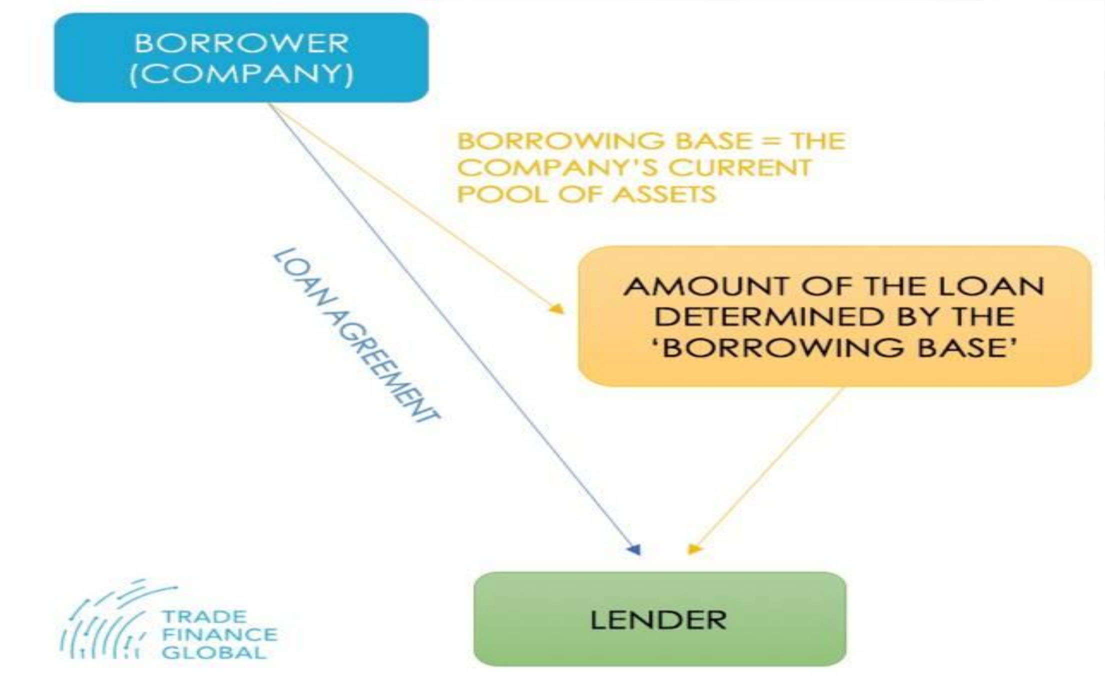
- Project Loan Agreement
- Security Documents

3. Project Document

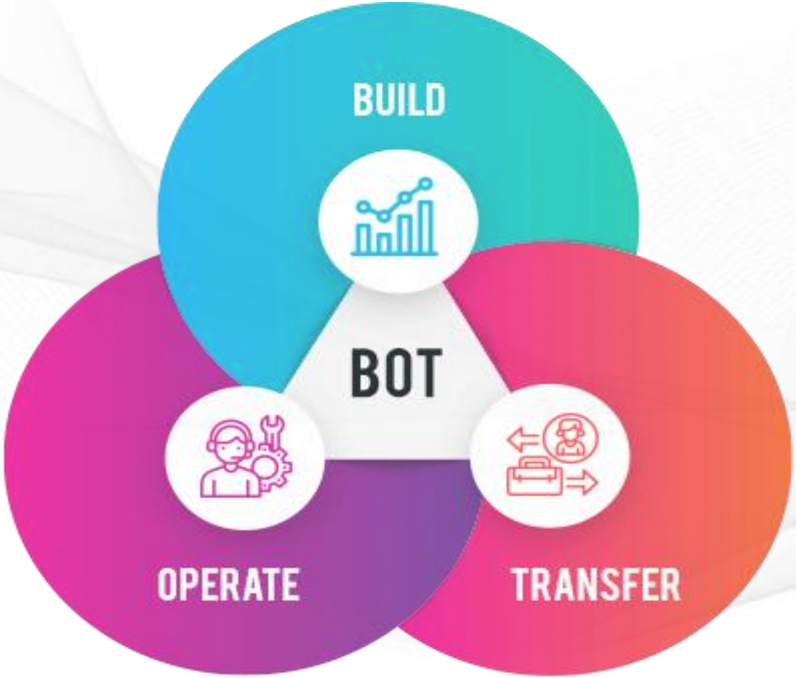
- Concession Agreement/License
- Construction Contracts
- Operation & Maintenance Agreement
- Fuel Supply Agreement
- Off take Agreement
- Other Project Documents

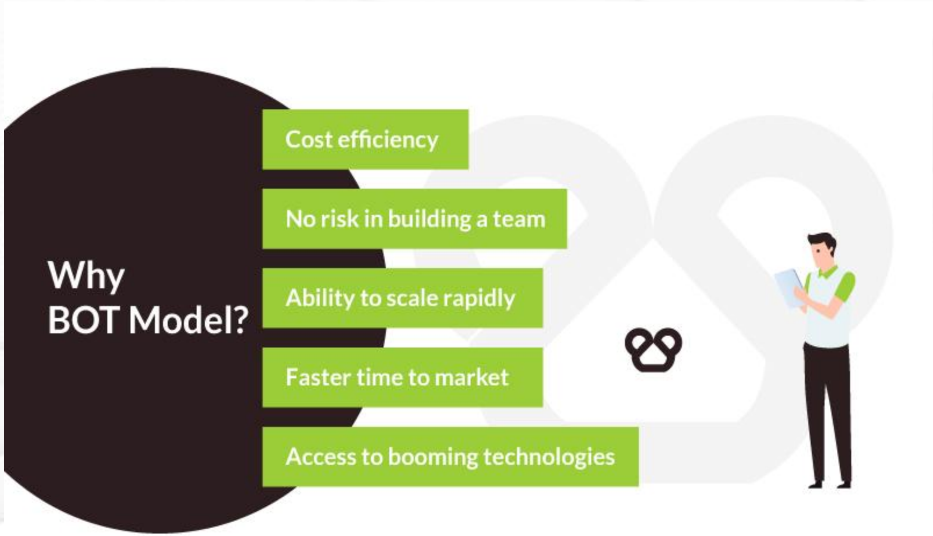
Approach of Project Financing

- Debt
- Equity
- Forward Purchase
- Bond
- Leasing
- Borrowing Base Model

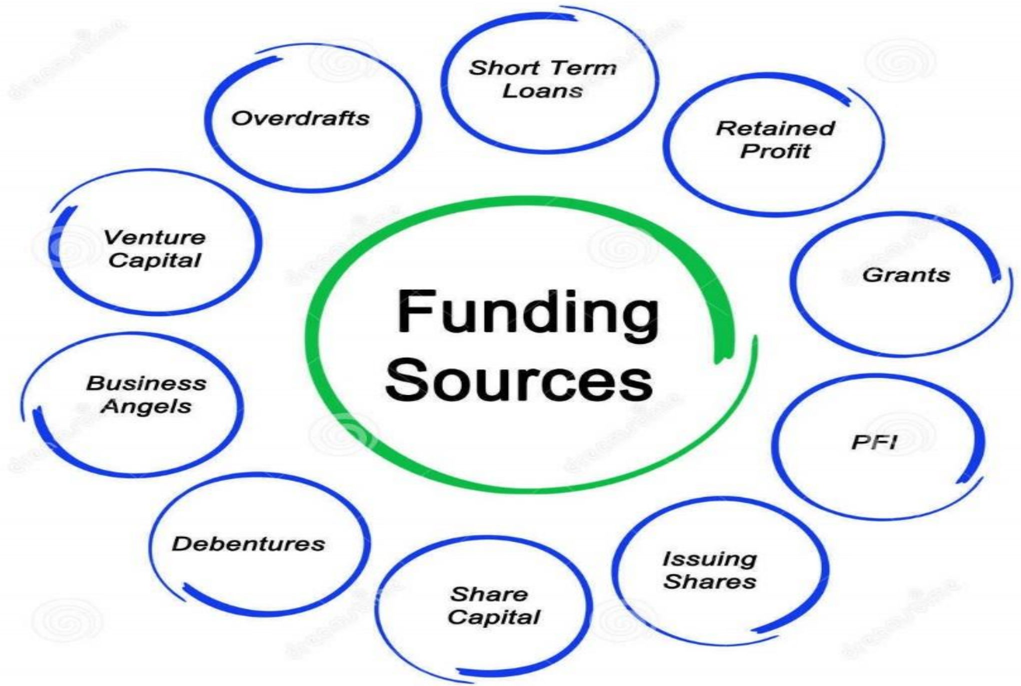


BOT Model of Project…





Major Sources of Financing



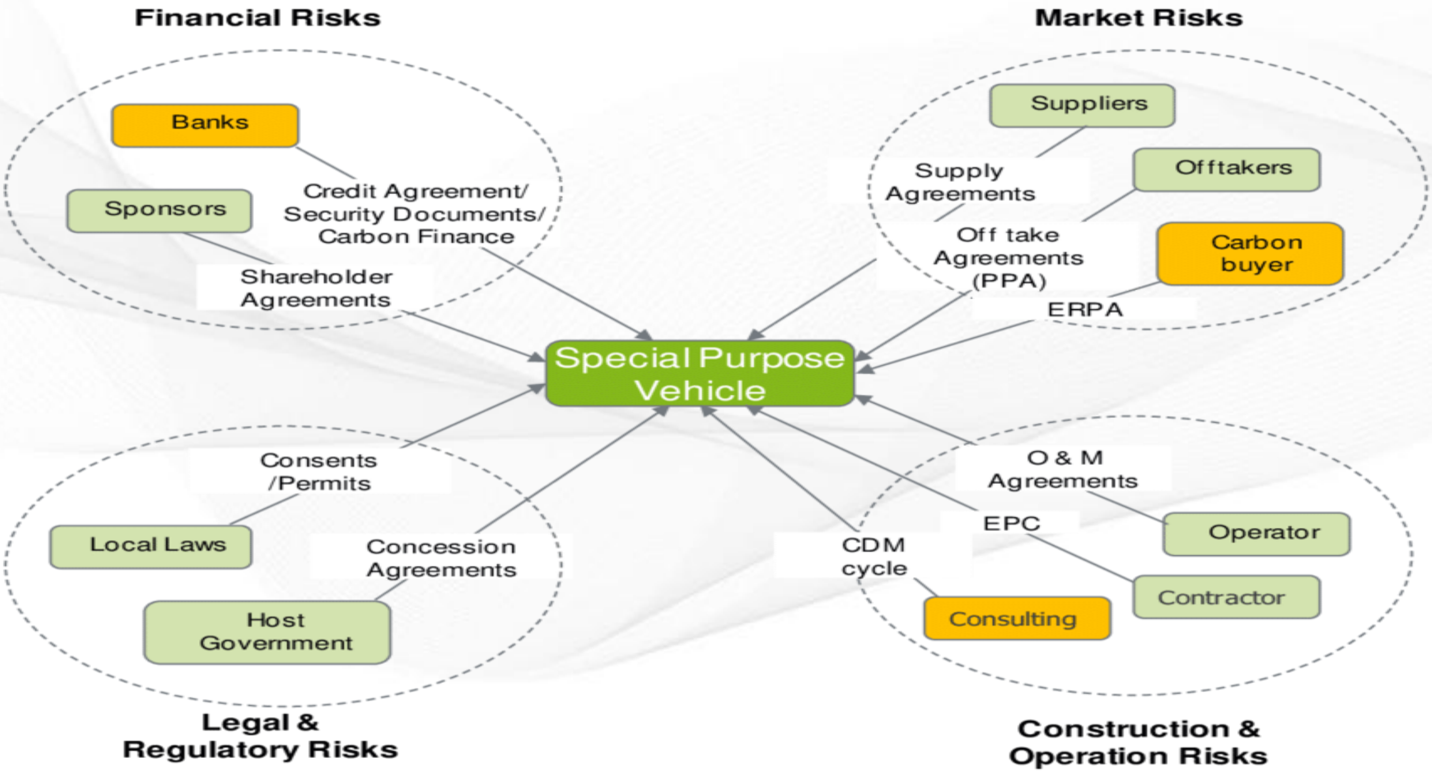
Risks in Project Financing

- Construction Completion Risk
- Operating Risk
- Market Risk- Demand, Competition, Pricing….
- Political Risk- Intervention of political parties and law and order
- Reserve/Production Risk- Risk of not making optimum production level
- Counterparty Risk-any counterparty of this project might default
- Legal & Structural Risk

Securities in Project Financing…

- Adequate Equity
- Escrow/TRA
- Collateral
- DSRA
- Insurance
- Guarantee of the parent company/promoters
- Comfort Letters

Risk Mitigation by Documentation



Need of Insurance to Mitigate Natural Disasters

The major threats are:

- Fire
- Theft
- Earthquake
- Flood
- Third Party Accident

Project Finance – The Role of Insurance

Insurance and Bankability

- Funds loss of or damage to project assets
- Secures income streams which are fundamental to loan repayment
- Funds delay in project completion
- Minimizes the completion risk of the project
- Enhances project credit
- Insurance in a project becomes a form of collateral or an enhanced form of security for the Sponsor and the Lenders

Project Loan Agreement

Major parts of Project Loan Agreement are as followed:

- Warranties, Covenants & Event of default (security in case of default)
- Project Bank Account (TRA/Escrow)
- Appointment of Expert (Operational Efficiency)
- Information & Access (Financial, Generation, Running Account Bills, Debtor etc.)
- Cover Ratios (Financial Ratios)
- Governing Law & Jurisdiction (Legal portion that binds both the parties)
- Completion Issue (Deadline)

Export Credit Agencies & Multi Lateral Agreement

- An export credit agency or investment insurance agency is a private or quasi-governmental institution that acts as an intermediary between national governments and exporters to issue export insurance solutions, guarantees for financing.

- The multilateral agencies consist of the various global and regional development banks and funds (like Asian Development Bank). They are becoming increasingly important sources of project finance

- In many cases, their original objective was to channel financing for infrastructure projects and other public works to governments and state-controlled agencies in the relevant part of the world.

Thank You