Project Financing- The concept

- A method of financing an economically viable project on the basis of future cash flows, it is expected to generate.
- The main feature are as under:
- A separate legal entity.
- Its cash flows are segregated from the sponsoring organization and deposited to a separate account.
- Sponsor can be main user of its output, contractor/supplier or consortium or Govt.

Project Financing--contd

- Revenue cash inflows generated from the project should be adequate to cover the following
  - All operating expenses
  - Debt-serving obligations
  - Adequate return to equity holders
- All risks borne by the project.

Project Financing--contd

- Large scale (capital intensive) projects involving high proportion of debt finance provided by group of lenders, such as
  - Toll roads
  - Tunnels
  - Bridges
  - Ports
  - Power projects
  - Rail projects
- Not dependent on credit support of the sponsors

Project Financing--contd

- Dependent on expected cash flows and collateral value of only project assets.
- Lenders have no resource to sponsor’s balance sheet in case of project failures.
- High confidence needed in the performance of the project.
- In-depth /extensive appraisal required to have ascertain accuracy of cash flows i.e. ascertaining risks of different types affecting cash flows.

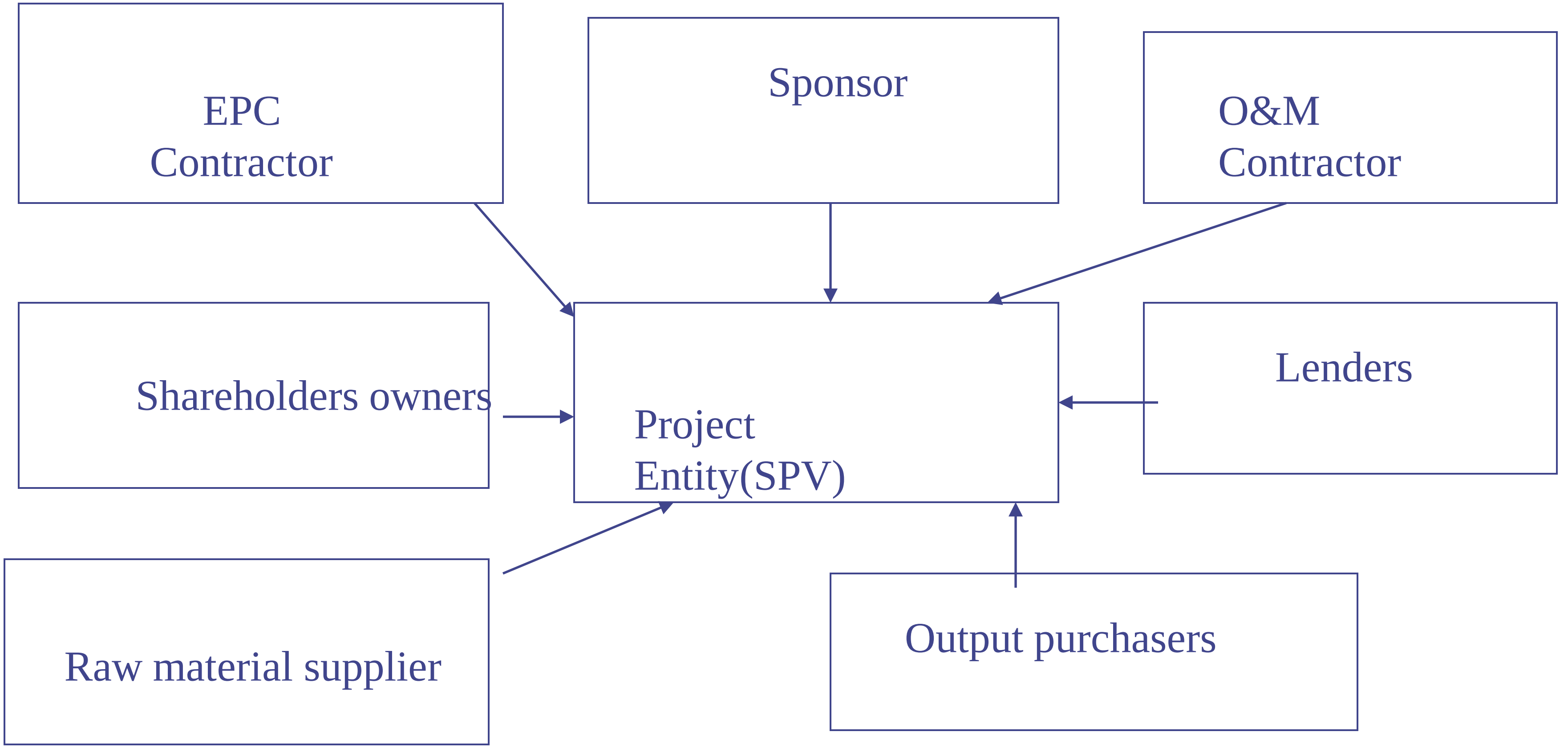
Project Financing--contd

- Customized project financing packages.
- Careful financial engineering to allocate risks and rewards amongst the participants.
- Strong demand for output of the project.
- EPC Contractor responsible for timely implementation and starting of commercial production.

Project Financing--contd

- O&M contractor responsible for professional operation and maintenance during the life of the project.
- Sponsor undertake bidding financing and implementing

Typical Project structure



Advantages of Project Financing

- Risk are shared by competent parties.
- Sponsors are able to raise higher debts due to in-built security of output purchasers even when having lower credit rating and avail tax shield benefits raising for value.
- Lower agency cost of debt due to clear nature and boundaries of project finance leading to lower interest rate.
- Lower agency cost of free cash flow due to lesser possibility of diversion of funds.

Advantages of Project Financing--contd

- Project failures does not affects the share prices of the sponsors much due to clear information about the project.
- Better appraisal of the performance of project managers in stand alone projects.
- Managerial incentives can be tied with performance of the project.

Non-Transfer Options

- Build-Own and Operate (BOO)
- Rehabilitative –Own and Operate(ROO)
- Contract-Add and Operate(CAO)
- Build-Own, Operate and Manage(BOOM)
- Rehabilitative –Own, Operate & Manage (ROOM)

Non Lease Transfer Options

- Build and Transfer(BT)
- Build,Own and Transfer(BOT)
- Build, Transfer-Operate(Lease)-BTO
- Build-Own-Operate and Transfer(BOOT)
- Buy-Build-Operate Transfer(BBOT)
- Refurbish-Operate-Transfer(ROT)
- Develop-Operate and Transfer(DOT)

Lease Transfer Options

- Build-Own-Lease-Transfer(BOLT)-OYW
- Build-Lease and Transfer(BLT

Types of agreements

- Engg, procurement and construction (EPC) contract
- Operation & Maintenance (O&M) contact
- Raw material assured supply contract
- Output purchase contracts
- Financial guarantee agreement(letter of credit)
- Sponsors guarantee agreement
- Cash deficiency agreement
- Capital subscription agreement
- Cash back agreements.

Types of agreements- contd.

- Concession agreement for levy of fees etc.
- Shareholder's agreement- rights and obligations of the shareholder.

Project Risk Sharing Mechanism

- Basic principles
  - Allocate to party well equipped to handle it effectively.
  - Be fair

Types of Project Risks

- Operating risks
- Construction risks
- Technology risks
- Performance risks
- Market risks
- Liability risks(death or injury during operations)

Financial Risks

- Interest rate risk
- Currency risk

Examples Of Projects

Sponsor	Project	Product	Capacity	Cost (Rs in Cr)
Inter Corp.Ind.	Kemeng Hydel	Hydro electricity	600MW	1300
CESE	Budge Budge	Thermal electricity	500MW	2308
GAIL	Hazira pipelines	Pipelines transport	505km	2376
Gujarat Pipavav	Port project	Port		575

Cases

- NOIDA TOLL BRIDGE
- NOIDA Toll Bridge by IL&FS through Noida Toll Bridge Company Ltd (NTBCL) an SPV
- Marubeni-Mitsui Corporation-EPC Contractor. EPC contract provides for

✓ Payment of liquidity damage to NTBCL(SPV) for non-performance/delay in completion@1/18 % of the cost of project for each day for a maximum period of six months subject to overall limit of 10% of the contract value.

✓ Performance guarantee by EPC contractor @10% of contract value i.e. Rs. 21.1 crore.

Case II-Wind Power Project

Risk	Allocation
Technology Risk	EPC Contractor liable for liquidated damages
Construction completion Risk	Fixed price contract with clauses coverage liquidated damages.
Revenue risks due to variation wind potential	Minimum Payment from the power purchaser to cover O&M expenses and debt-services
Payment/Credit Risk	BG or Govt.guarantee for power purchase

Funding Agencies (Sources of Funds)

- World Bank
- Asian Development Bank
- International Finance Corporation
- Infrastructure Funds
- Global Power Investments of GE Capital
- Asian Infrastructure Fund
- ICICI power of ICICI mutual fund

Funding Agencies (Sources of Funds)

- Export-Credit agencies for financing important equipments.
- All India Financial Institutions(IDBI, ICICI, IFCI)
- Infrastructure Leasing & Finance Services and (Joint venture of central Bank of India, UTI & HDFC)
- Infrastructure Development Finance Company(IDFC)
- Cyndicated Credit Market

Functions of Funding agencies

- Term loan
- Guarantees
- Equity participation

Factors for success of Project Financing

- No significant correlation between cost and revenue of the project with those of the parent company.
- Participants to have sound understand of
  - Cost & time required to complete the project
  - Pattern of cash flows
  - Risk involved

Factors for success of Project Financing--contd

- Separate Project Company(SPV) for risk pooling and sharing of expertise.
- High creditworthiness of the sponsor
- Supply contracts in place.
- Financially viable project.
- Established Product/Service Demand/Market
- Competent EPC contractor
- Technical expertise to operate the project or competent O&M contractor
- All Govt. approvals obtained
- Adequate insurance of project asset