PROJECT FINANCE
and
TERM LOAN ASSESSMENT

S. K. Sachdev
IDBI Bank Ltd.
During the day........

- Project Financing/Appraisal
- Products of Corporate financing
- Question and answer session
Types of Project

- Green field vs Brown field
- Expansion, Modernisation, Diversification
- Infra vs Non-infra
- Recourse vs Non-recourse
PROJECT FINANCE

- A funding structure that relies on future cash flow from a specific development as the primary source of repayment, with that development’s assets, rights and interest legally held as collateral security.

- Contrast to conventional corporate lending which looks to the balance sheet and total business and financial resources of a borrower as the source of repayment.
Pre-requisite if Project Appraisal

- Working Knowledge of Industry
  - Industry Dynamics and economics
  - Requirement and source of inputs
  - Manufacturing process
  - Business Environment
  - Manufacturing / Operating Cycle
Pre-requisite if Project Appraisal

- Government Policy Guidelines and updates
- Institutional Norms
- Accounting Concepts and Policies
- Working Knowledge of Spreadsheets and Word Processing Applications
- Effective Communication
- Ability to identify critical elements from general ones, mitigate obvious risks so as to improve viability
APPRAISAL – why?

- Project returns are spread over time
- Each variable effecting NPV is subject to high level of uncertainty.
- Information and data needed for more accurate forecasts are costly to acquire.
- Need to reduce the likelihood to undertake a “BAD” project while not failing to accept a “GOOD” project.
- Ultimately leads to Risk Assessment and “credit delivery” decision.
“Viability” is in the eyes of the beholder

- Appraisal from whose point of view?
- What are the “viability parameters” that needs to be achieved?
- In the range of possibilities:
  - Best Case scenario
  - Worst Case scenario
  - Most likely scenario
APPRAISAL – WHY?

- Extend assistance to “viable” [“bankable”] projects
- Viability means -
  - Ability to service debt
  - Ability to service equity
  - Co. should earn for itself
- Allocate scarce resources
  - Optimally
STEPS IN APPRAISAL PROCESS

- Receipt of enquiry/application
- Initial screening-accept/reject
- If accepted, conduct detailed appraisal for credit decision
- Issue letter of intent (LoI) [“The Offer”]
PROJECT APPRAISAL

- Broad areas of appraisal
  - Promoters & management
  - Market analysis
  - Technical analysis
  - Financial analysis
  - Risk assessment and contracting [“covenant”]
PROMOTER ASSESSMENT

- Most subjective aspect
- Types of promoters
  - Existing companies
  - First generation
  - Government/PSUs
  - Foreign promoters
- Promoters vs Management
PROMOTER ASSESSMENT

- Existing companies
  - Track record of performance
  - Analysis of B/S and P& L A/c
  - Dealings with FI’s/banks
  - Ability to bring in required funds
PROMOTER ASSESSMENT

- First generation
  - Individual promoters (limited tools)
  - IT/Wealth Tax returns
  - Bankers’ report
  - Qualifications/past experience
  - Technical partner
MANAGEMENT ASPECTS

- Quality of the Board
- Promoter Directors vs. Independent Directors
- Project execution team
- Management structure during operation
- Chief executive
- Other functional heads
MARKET ASSESSMENT

- Nature of the product
  - Applications
  - Competing products
- Industry structure
- Existing & projected unsatisfied demand
- Supply scenario & competitors
- Product obsolescence
- Selling arrangements
TECHNICAL ASPECTS

- Various areas covered are
  - Locational aspects
  - Process
  - Technical arrangements
  - Raw materials
  - Utilities
  - Environmental factors
  - Manpower
  - Implementation schedule
LOCATION

- Location
  - Proximity to markets [e.g. perishable products]
  - Proximity to raw material supplies [resource based, imported raw material]
  - Availability of labour [quality, quantity, cost, relations]
  - Availability of utilities
  - Effluent disposal
  - Other infrastructure [power, transportation, water etc]
  - Governmental Policies [restrictions and sops]
LOCATION -SITE

- Requirement of land area to be assessed based on
  - Plant layout
  - Expansion needs
- Soil test report
- Load bearing capacity
- Extent of development/leveling
- Obtaining utility connections [costs]
  [transmission lines, railway sidings, feeder road, water, effluent disposal]
PROCESS

- Has relationship to capacity, inputs and product-mix
- Latest and proven
- Cost effective – both from initial investment and production cost
- Alternate processes
- Advantages w.r.to
  - Cost
  - Consumption of inputs
  - Ease of operation/Upgradeable
  - Pollution aspects
PROCESS

- New process or processes used first time in the country
- Background of the process know-how supplier
  - Financial status
  - Technical capability
  - Reference plants
- Ad hoc committee of advisers
TECHNICAL ARRANGEMENTS

- Technical collaboration
- Licensor of know-how/basic engineering
- Patents
- Plant & machinery
- Guarantees/warrantees – Collaborator/ P&M supplier /Detailed engg contractor
- Approach to “force majeure” conditions
- Assignment in case of ownership
- Termination
TECHNICAL ARRANGEMENTS

- Technical know-how agreement
  - Supply/vetting of basic engineering
  - Guarantees
  - Liquidated damages for non-performance
  - Training of personnel
  - Royalty
  - Indemnity
TECHNICAL ARRANGEMENTS

- Size of plant
  - Minimum economic size which varies with change in technology, products, pricing, demand etc.
- Plant & Machinery
  - Suitability & adequacy [transporting, trained personnel availability]
  - Reasonableness of cost
  - Reputation of suppliers
  - Line balancing
  - Spare parts
RAW MATERIALS

- Raw materials & quantity
- Sustained availability
  - Imported /indigenous
  - Major suppliers
- Prices of raw material
  - Price volatility
  - Past trends
  - Duties
- Arrangements for supply.
UTILITIES

- Power supply
- Water
- Labour
  - Requirement/availability
  - Arrangements
- Measures to augment supplies/fall back [power?]
EFFLUENT DISPOSAL

- Liquid, gaseous & solid effluents
- Pollutant load needs to be assessed
- Depending on the volume and quality of the effluent suitable treatment measures are designed.
- Environmental impact assessment study
- Clearances from statutory authorities
List down all activities from “planning” to “COD”
- Time required for each step
- Scheduling of activities - PERT/CPM
- Resource required [impact of more or less resource]
- Schedule of machinery supply
- Experience of similar plants
IMPLEMENTATION SCHEDULE

- Consequences of delay
  - Increase in project cost
  - Funding overrun
  - Effect on viability
  - Loss of market
  - Confidence level of FIs
PROJECT COST ESTIMATION

- Major heads are
  - Land and site development
  - Buildings/civil works
  - Plant & machinery
    - Imported
    - Indigenous
  - Tech. Know-how fees
PROJECT COST ESTIMATION

- Expense on foreign technicians & training
- Misc. fixed assets
- Prel. & Pre-op expenses
- Contingency
- Margin money for working capital
Margin Money for Working Capital

**Current Assets**
- Raw Materials (Imp. - 3 mths/Ind -1 mth)
- Work-in-process (1 process cycle time)
- Finished goods (1 wk to 1 mth)
- Receivables/ Debtors (30 days to 90 days)
- Other expenses (1 month)

**Current Liabilities**
- Creditors (1 month’s RM & consumables)
MEANS OF FINANCE

- Basic criteria
  - Promoters’ contribution
  - Core promoters’ share
  - Debt-equity ratio
- Normal DER – 1.5:1 (max.)
- Flexible for larger projects, infrastructure
MEANS OF FINANCE

- General considerations
  - Capital intensity
  - Risk perception
  - Serviceability – debt/equity
MEANS OF FINANCE

- Equity
  - Share capital
  - Convertible part of PCD (if converted in 18 months)
  - Pref. Share Capital (> 3 yrs)
  - Internal accruals
MEANS OF FINANCE

- Quasi – equity
  - Subsidy
  - Subordinated loans from promoters
  - Incentive loans
MEANS OF FINANCE

- Debt
  - Rupee term loans
  - FC loans
  - Pref. Capital (< 3 yrs.)
  - Debentures
  - ECB
  - Suppliers’ credit
MEANS OF FINANCE

- Security package
  - First charge on fixed assets
  - Second charge on movables
- Personal guarantees
- Corporate guarantees
- Pledge of shares
- Govt. Guarantee/escrow
- Assignment of contracts
FINANCIAL VIABILITY

- Estimates of profitability, cash-flow and balance sheet
- Assumptions underlying profitability projections
- Critical assumptions
  - Installed capacity
  - Capacity utilisation
  - Product mix
  - Sales realisation
  - Consumption of inputs & prices
FINANCIAL VIABILITY

- Compare profitability with that of existing firms in similar line, particularly the PBIDT margin.

- Computation of IRR
  - Rate of discount which equates the pv of capex in the project to pv of net cash flow over the life of the project.
  - Is compared with cost of capital
FINANCIAL VIABILITY

- Whether sufficient cash flow to service debt.

- Debt-service coverage ratio
  - \( \frac{(\text{Gross cash accr.} + \text{Int. on term debt})}{(\text{repayment of debt} + \text{int. on term loan})} \)
  - Computed yearly as well as average over the repayment period
  - Av. DSCR to be > 1.5
  - Yearly DSCR > 1.3

- Other ratios- BEP, CBEP
FINANCIAL VIABILITY

- Sensitivity analysis
  - Effect of adverse variance of critical elements on viability is examined
- Typical tests are
  - Reducing sales vol./Price
  - Increasing cost of inputs
  - Increase in project cost
  - Effect of FE fluctuation
  - Reduction in capacity utilisation.
ECONOMIC APPRAISAL

- Social cost benefit assessment
- Qualitative & Quantitative

**Qualitative**

- Social costs –
  - Environmental pollution
  - Ecological imbalances
  - Forest degradation
  - Accidents
  - Threat to animal life
Economic appraisal

- Social benefits
  - Improved facilities like roads, irrigation, sanitation etc.
  - Improved transport facilities
  - More job opportunities
  - General economic improvement
  - Better living standards
Economic appraisal

- Actual cost & benefits not true representation of economic cost
- Two aspects of economic viability - benefits accruing to the economy and international competitiveness
Security for the assistance

- SECURITY PACKAGE
  - FIRST CHARGE ON FIXED ASSETS
  - SECOND CHARGE ON MOVABLES
  - PERSONAL GUARANTEES
  - CORPORATE GUARANTEES
  - PLEDGE OF SHARES
  - GOVT. GUARANTEE/ESCROW

- SECURITY MARGIN
  \[1 - \left(\frac{\text{SECURED DEBT}}{\text{F.A}}\right)\] \times 100

- FIXED ASSETS COVERAGE
  \(\frac{\text{FA}}{\text{DEBT}}\)
Financial Terms

- Rate of interest - Fixed, semi variable or variable
- Reset clause
- ROI on FC loans - LIBOR - Hedging cost
- Upfront fee / Syndication fee / Appraisal fee
- LC/BG charges
- Availability period
Financial terms

- Repayment schedule - Moratorium
- Additional interest/ Penal interest/ LDs
- Prepayment clause
- Security creation stipulation
- Financial covenants - Triggers
- Lenders’ Agent/ Security Trustee/ TRA Agent/LIE/ LLC/ LIA

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PRUDENTIAL NORMS

- **Individual exposure limits**
  - 15% of total capital funds of the Bank
  - + 5% (for infrastructure projects)
  - + 5% (with the approval of the Board)

- **Group Exposure**
  - 40% of total capital funds of the Bank
  - + 5% (for infrastructure projects)
  - + 5% (with the approval of the Board)
Exposure Norms (Decided by respective Bank)

- **Company**
  - Rs.3000 crore + Rs.1000 crore for infrastructure funding

- **Group**
  - Rs.8000 crore + Rs.2000 crore for infrastructure funding

- **Exposure to industry Sector**
  - 10% to 15% of total customer Exposure
THANK YOU