



Hyde Park Consultants Pty Limited
Project Financial Advisory Services

The Impact of Project Finance on Sponsors

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Overview

- What is project finance
- Advantages and disadvantages
- Restrictions on operations and Sponsors
- How to get the best deal
- Typical legal structure
- Other Sponsor considerations

Definition

*...financing of a particular **economic unit** in which a lender is satisfied to look initially to the [forecast] **cash flows** and earnings of that economic unit as the source of funds from which a loan will be repaid and to the **assets of the economic unit as collateral** for the loan.*

Nevitt and Fabozzi (1995), 'Project Financing Sixth Edition', Peter K Nevitt and Frank Fabozzi, Euromoney Publications, 1995

Project Finance

- So what is it?
 - Raising finance for an asset that can be “**ring fenced**” legally and operationally.
 - Once performance is demonstrated, lenders have **limited recourse** to assets or entities other than the Project itself.
 - Finance has minimal financial impact on other parts of a company.
 - Requires detailed terms and conditions.

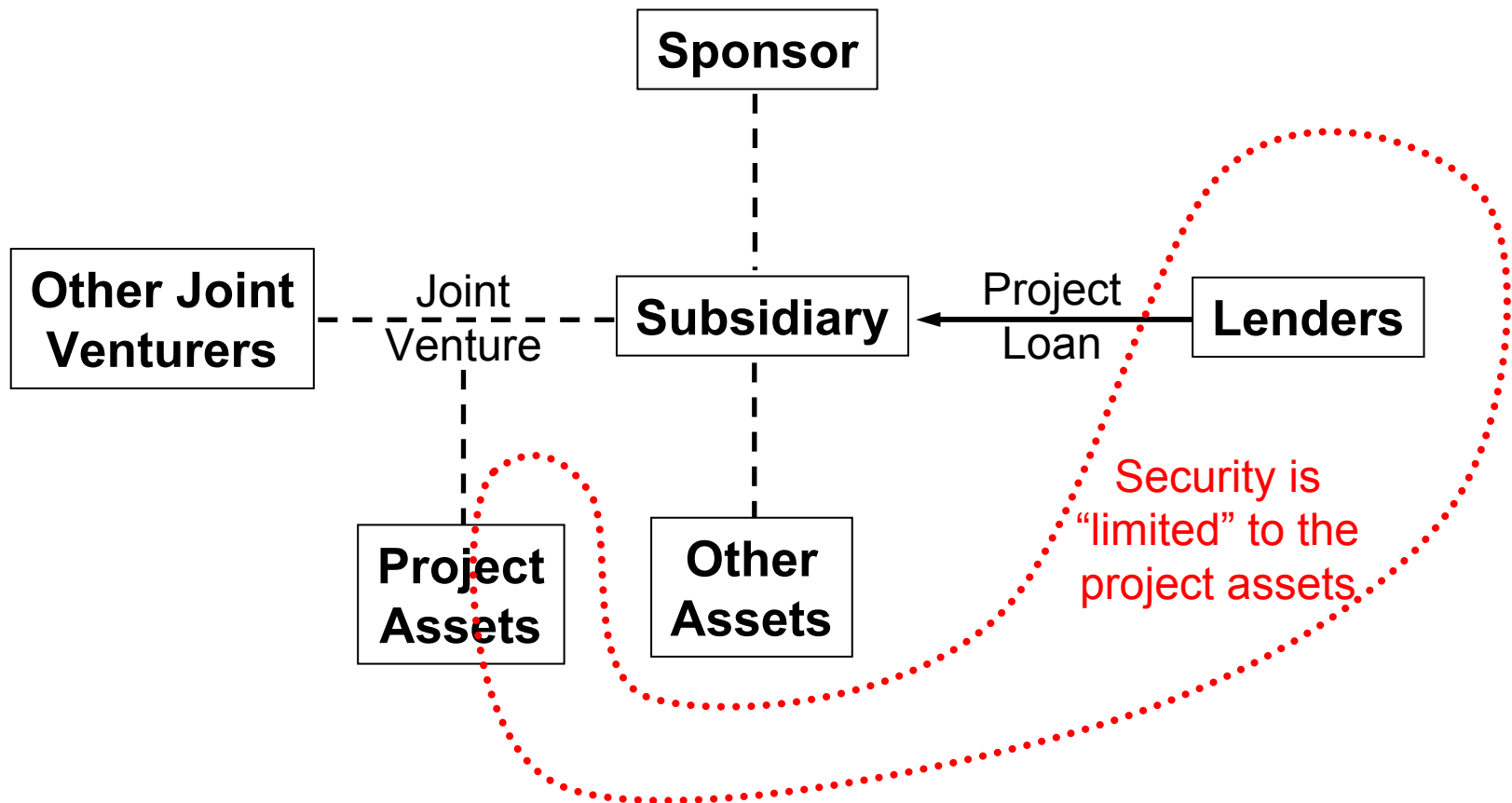
Applicable Assets

- Features:
 - Assets can be identified and ideally ring fenced.
 - Assets are forecast to be economically and financially viable.
 - Asset risks can be assessed and managed.
 - Asset size justifies the cost of project finance.

Non-recourse Debt

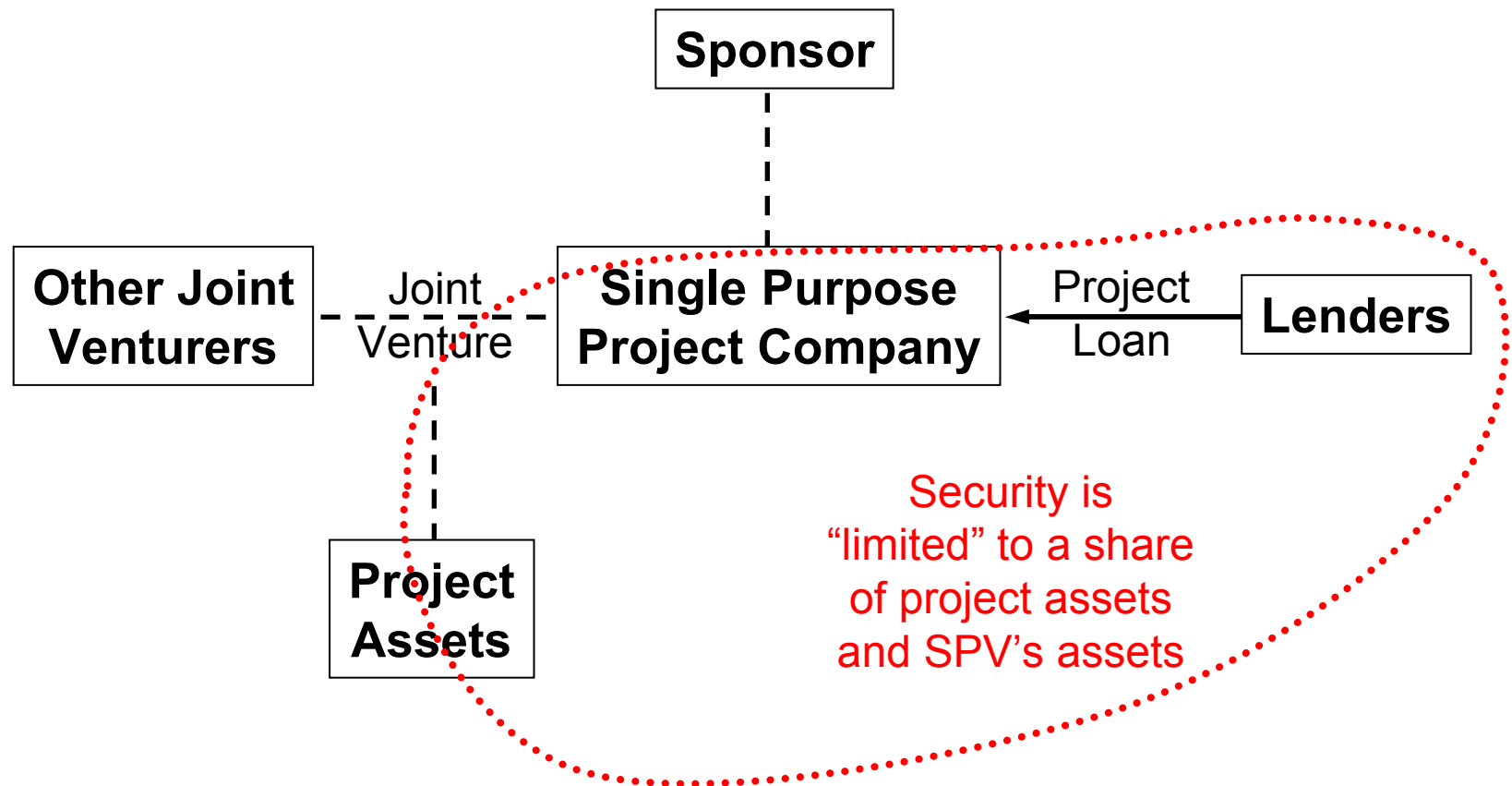
- Project finance is typically “limited” recourse, not “non-recourse”.
- Recourse is usually **limited** to the project assets with additional support required from the project sponsors for (inter alia):
 - completion (achievement and funding)
 - management capability
 - (possibly) cross default provisions.
- Security will include project agreements with the approval of each counterparty and possibly tripartite agreements to amend specific clauses.

“Limited” Recourse #1



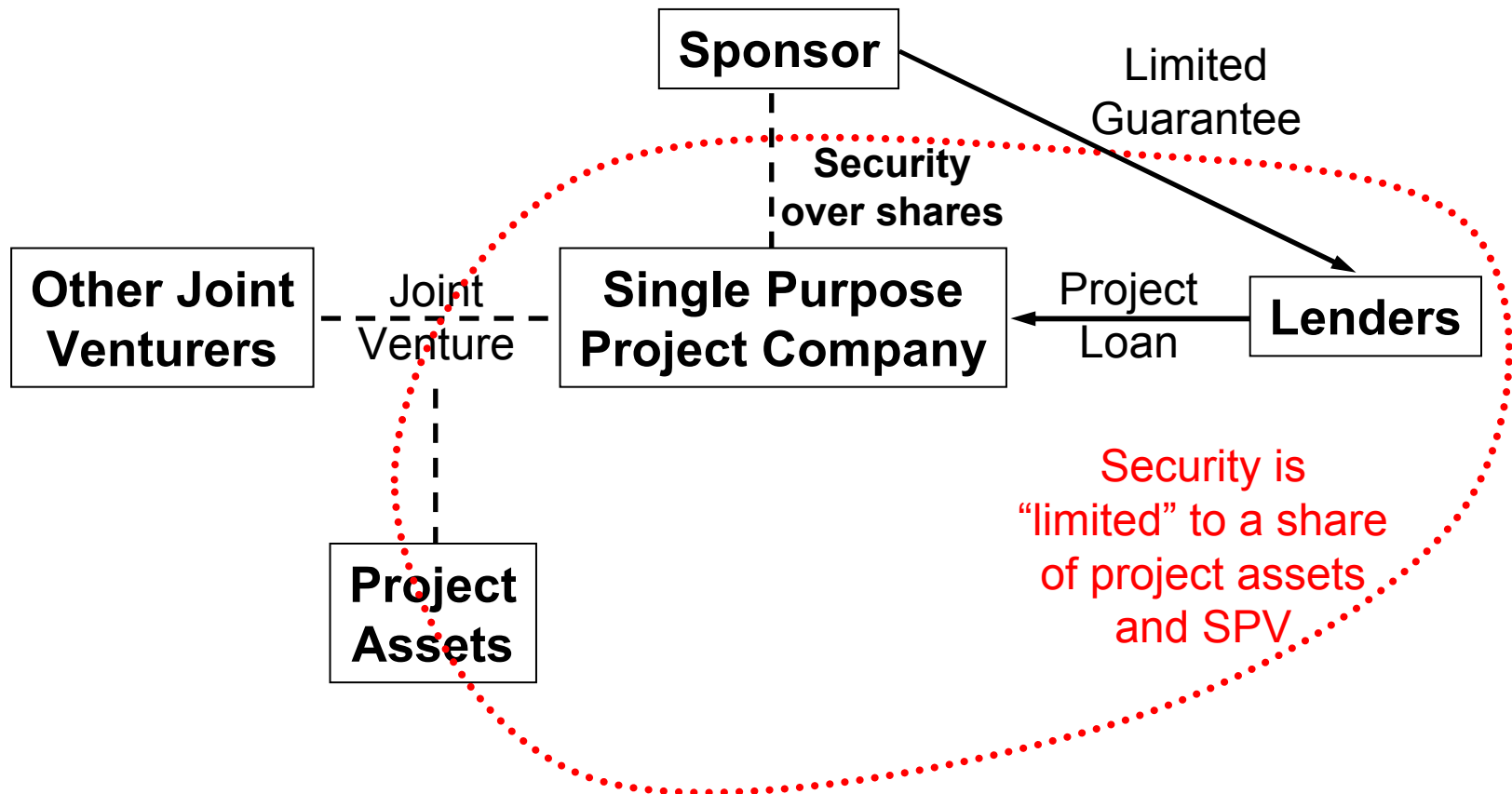
THIS STRUCTURE IS HIGHLY UNUSUAL

“Limited” Recourse #2



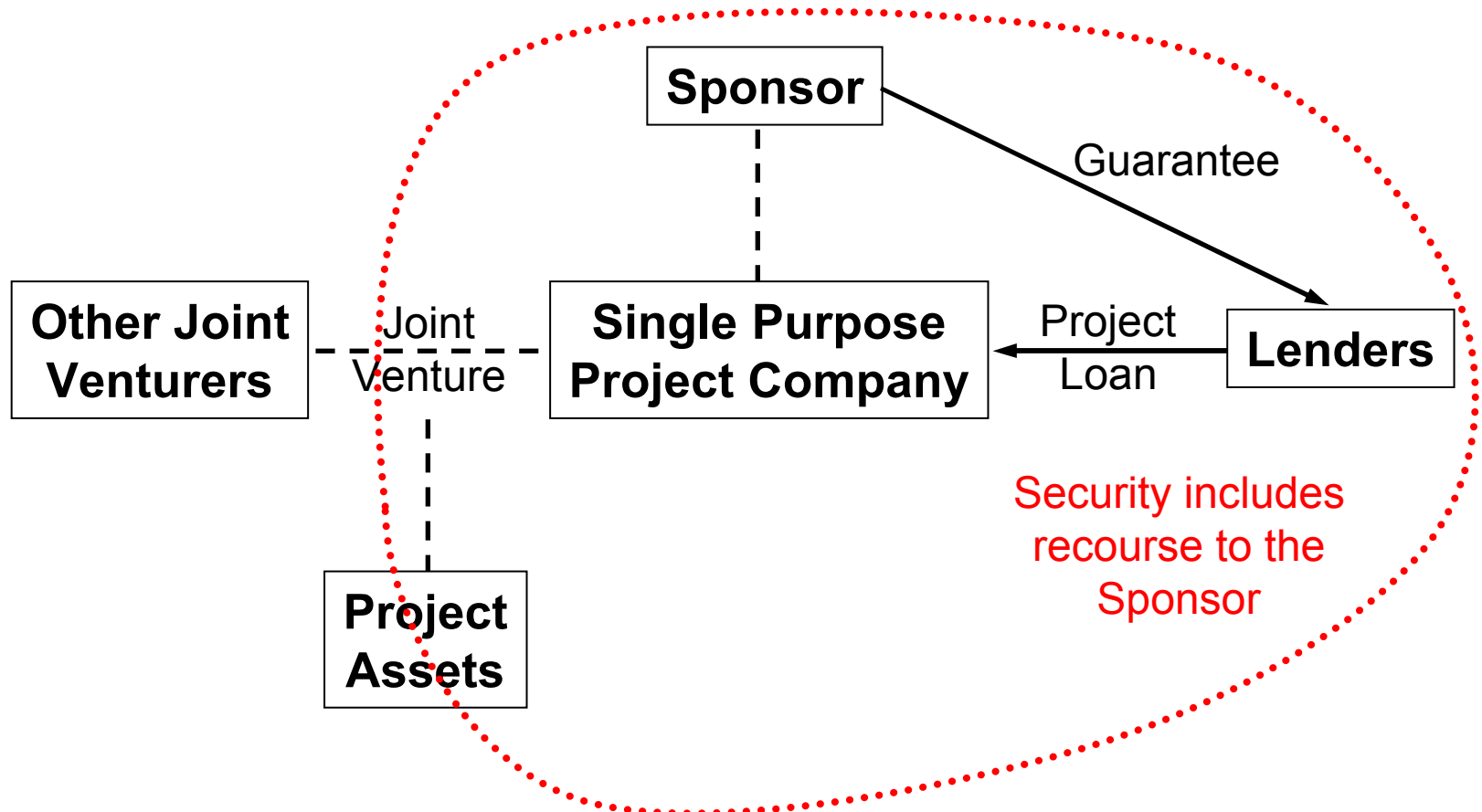
THIS STRUCTURE IS COMMONLY USED

“Limited” Recourse #3



THIS STRUCTURE IS ALSO COMMONLY USED

“Full” Recourse



THIS STRUCTURE IS UNUSAL AFTER COMPLETION

So....

- It is usual for Lenders to require a Sponsor “guarantee” which is **limited only to the shares in the special purpose project company**.
- “Full” recourse applies when Lenders can force Sponsor to **repay the debt in full** as an unsecured creditor or through security over other Sponsor assets.

Forecast Cash Flows

- Lenders rely primarily on project cash flows for repayment, hence:
 - they will require the forecast assumptions to be independently verified; and
 - they will require a detailed financial model of the project – it is **ALWAYS** better to provide one to the lenders rather than let them prepare one.

Financial Model

- Possibly the most **CRITICAL** part of a project financing.
- Need to balance detail with accuracy:
 - must accurately reflect project dynamics;
but
 - should not be so detailed that it cannot be understood or used by others.
- Lenders may actually determine some assumptions (e.g. FX, interest rates and market prices).

Financial Covenants

- The model may continue to be used to monitor financial covenants, hence:
 - it may have to be continually updated;
 - Sponsors may not have control, especially if updated by the project operator or bank Agent.
- Timing of financial reporting and model updates can be **critical**.

Advantages and Disadvantages

- To project sponsors
- To project lenders

Advantages

- To project sponsors:
 - ✓ Isolates risk
 - ✓ Longer term
 - ✓ Tailored drawdown and repayment terms
 - ✓ Risks shared with lenders
 - ✓ Sponsor's own credit rating not as important
 - ✓ Limited covenants on sponsors
- To lenders:
 - ✓ Higher returns
 - ✓ Industry recognition

Disadvantages

- To project sponsors:
 - ✓ Higher cost
 - ✓ More complex
 - ✓ Slower to complete
 - ✓ Controls on use of cash flow surpluses
- To lenders:
 - ✓ Higher risks
 - ✓ Cost and time to evaluate
 - ✓ Specialist (high cost) skills required

Restrictions on Operations

- Lenders are taking project risk hence will be concerned about project performance
- **Lenders will typically require:**
 - bank accounts for revenue, insurance, cash retentions, etc;
 - cash flow sweeps;
 - detailed reporting of operations;
 - approved annual budgets;
 - additional security to support equity funding;
 - restrictions on advances (cost to complete test);
 - performance tests;
 - restrictions on cash releases;
 - hedging – prices, FX, interest rates;
 - restrictions on other indebtedness;
 - approval for change of operator; and
 - World Bank environmental standards.

Financial Covenants

- Covenants typically include:
 - cash retention accounts;
 - maintain minimum ratios:
 - cash cover
 - gearing
 - net present value of future cash flows
 - reserves;
 - negative pledges over project assets;
 - undertaking not to sell substantial assets;
 - undertaking not to provide financial assistance;
 - maintain approved insurances;
 - allow banks and their advisors access to project and accounting records; and
 - compliance with project agreements (including enforcement) and not to amend without lender approval.

Restrictions on Sponsors

- Completion support:
 - guarantee of debt until test met;
 - guarantee of adequate funding to meet test; or
 - guarantee of actual physical performance.
- After completion very few, but may include:
 - restrictions on change of ownership;
 - restrictions on changing operators;
 - restrictions on other parts of business if project dependent on them (eg marketing);
 - restrictions on use of insurance proceeds; and
 - tax grouping agreements and restrictions.
- Sponsors may have to provide appropriate representations and warranties.

Are Guarantees “Limited”

- A guarantee of the project debt is “limited” in **amount** to the debt outstanding.
- A guarantee of performance may require an **unlimited amount** of money to be spent to achieve it, but commercially the amount is **usually less than the amount of debt**.
- Guarantees to achieve **certain ratios** are likely to be limited in amount to **less than the total amount of debt**.

Completion Test

- Can include:
 - physical completion, commissioning and all bills paid (other than normal retentions);
 - physical plant or project performance;
 - minimum sales revenue or prices;
 - maximum operating costs;
- Timing can be:
 - over a specific time frame for the entire test; or
 - over different time frames for each component of the test.

Events of Default

- May include:
 - financial non-payment;
 - misrepresentations;
 - cross default;
 - ratio maintenance;
 - administration, winding up, insolvency, etc;
 - enforcement against assets;
 - reduction of capital;
 - documents become unenforceable or in default;
 - loss of authorisations, approvals, etc;
 - Government interference;
 - change of control;
 - environmental breaches;
 - non-completion and abandonment;
 - change of operator without lenders' consent;
 - insurance not maintained; and
 - material adverse effect.

The Best Deal...

- Sponsors need to:
 - maintain competition for as long as possible;
 - use independent advisors who know the market; and
 - keep control of the process.

Advisors

- Role of the advisor:
 - manage preparation of BFS;
 - advise on contractual arrangement terms;
 - develop financial structure;
 - coordinate appointment of technical experts;
 - prepare information memorandums;
 - coordinate financiers;
 - organise field trips and technical meetings;
 - manage the documentation process; and
 - assist in financial close process.

Hyde Park Consultants

- Over 25 years experience in project finance and project evaluation.
- Can assist in:
 - project financial modelling;
 - drafting and negotiating terms and conditions;
 - understanding typical bank requirements;
 - preparation of Information Memorandums;
 - negotiations with potential lenders; and
 - coordination of independent experts.
- Contact details on www.hpconsult.com.au