



**CAFRAL**

CENTRE FOR ADVANCED FINANCIAL  
RESEARCH AND LEARNING

Promoted by Reserve Bank of India

# **Project Finance – How to get it right?**

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# CONTENTS

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**1. Perspective on Project Finance**

**2. Current Context**

**3. Who is Responsible ?**

**4. What is not right ?**

**5. Underlying Weaknesses**

**6. How to Get-it-Right ?**

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# PERSPECTIVE

- **Significance of Projects :**

- **Industrial & Infrastructure -**

- **Integral to Economic Growth**

- **Have Catalytic impact on  
Income and  
Employment Generation**

- **Involve and Impact  
multiple Stakeholders**



# PERSPECTIVE

- **History**

- **Pre-Liberalisation**

- **Most large projects taken up and fully funded by Govt.**

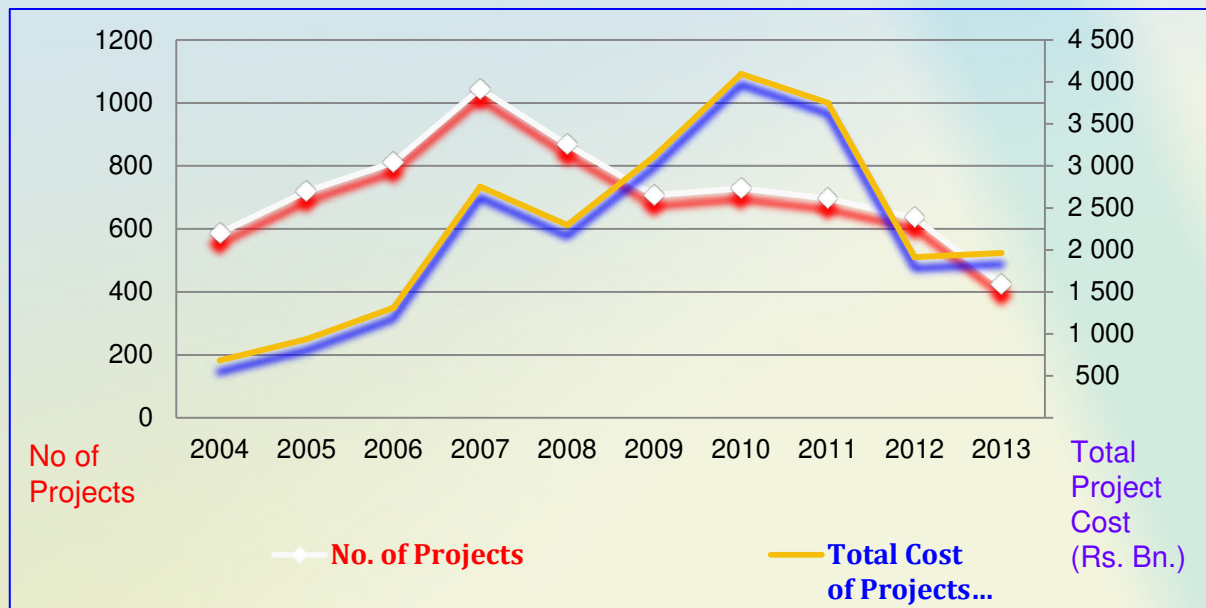
- **Post-Liberalisation**

- **Pvt. participation spurred through PPP or otherwise**
- **Increase in number of projects**
- **Increase in private funding and Bank Credit**

# PERSPECTIVE

## Bank/FI assisted Projects during 2004 - 2013

Year	No. of Projects	Total Cost of Projects (Rs.Bn.)
2003-04	587	685
2004-05	720	939
2005-06	812	1 313
2006-07	1 045	2 754
2007-08	868	2 297
2008-09	708	3 111
2009-10	729	4 095
2010-11	697	3 752
2011-12	636	1 916
2012-13	425	1 963



# CURRENT CONTEXT

- **Large No. of assisted Projects afflicted by Time & Cost Overruns (~75% in number)**

- **Includes 'Stalled' projects being monitored by PMG under Cabinet Committee on Investments No.: 384**

**Amt. : Rs.16874 Bn.**

**(of which 112 projects for Rs.4300 Bn. cleared till 19 Nov.)**

- **Many generating sub-optimal revenue**

- **Contributed to higher stress in Banking system**

- **Higher NPAs : 3.45% (Mar. 13) (4.2% : Sept.13)**

- **Higher Restructured Assets : 5.8% (Mar.13)**

- **Write-off as % of reduction in NPAs: 37.8% (Mar.13)**

- **Total Impaired Assets Ratio : As high as 12.1% for PSBs (Mar.13)**



# WHO IS RESPONSIBLE?

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- **Economic Slowdown: Global OR Domestic?**

- **Govt. Deptts.?**  
**(For delayed approvals/Clearances?)**

- **Promoters/Developers?**  
**(Low Competencies and Cushions?)**

- **Lenders / Banks ??**

- **Are we financing Projects rightly?**

# WHAT IS NOT RIGHT IN PROJECT FINANCE ?

**A. Lazy Origination**

**B. Deficient Due Diligence**

**C. Mis-allocation of Risks**

**D. Pre-mature release of Facilities**

**E. Weak Credit Administration**

**F. Shortsighted response to stress in portfolio**

# LAZY ORIGINATION

- **Arm-chair selling – Easy Way**
- **Quality compromised – Residual proposals**
- **Greater possibility of Group or Sector Concentration**



# DEFICIENT DUE DILIGENCE

- **Cost Estimation**

- **Firm / Non-firm**

- **INR / FC**

- **Peer Comparisons**

- **Implementation Period**

- **Cushions / Contingencies**

# DEFICIENT DUE DILIGENCE

- **Debt/Equity Balance**
  - **Level of Debt, Sustainable by Project Cash Flow**
  - **Promoters' Equity and its Sources**
  - **Forms of Equity, its Terms**
  - **Non-Disposal U/Ts and Pledge of Shares**
  - **Payout restrictions**

# DEFICIENT DUE DILIGENCE

- **Cash flow Estimation**

- **‘Realistic’ Assumptions of Revenue Buildup and Input Costs**

- **Considering Cyclical Changes**

- **Moratorium + Repayment Structure**

# DEFICIENT DUE DILIGENCE

- **Sensitivity Analysis**

- **On Revenues**

- **On major input costs**

- **On Project Cost**

- **On Implementation Period**

# DEFICIENT DUE DILIGENCE

- **Promoter Group Analysis**

- **Financials –  
Stand-alone and Consolidated**

- **Inter-Linkages**

- **Full Disclosures**

- **‘Adjusted’ TOL/TNW**

- **‘Arm’s Length’ Principle**

- **Opaque/  
Inter-twined Structures**

# RISK ALLOCATION AND MITIGATION



- **Follows Risk Identification and Analysis**

- **Allocation among Project Participants (Promoter/Equity holders, Machinery and Input Suppliers, Off-Takers, EPC Contractors, Lenders)**

- **To be Proper and Equitable**

- **Non-Recourse OR Full/Limited Recourse**

- **Conversion Option**

# RISK ALLOCATION AND MITIGATION

## Non-Recourse Financing

- **Necessity??**

- **Safeguards**

- **Cash flow generation through robust contractual structure**

- **Credible Project Participants**

- **Minimal Regulatory and Political Risk**

- **TRA with clearly defined provisions**



# RISK ALLOCATION AND MITIGATION

## **Non-Recourse Financing (Contd.)**

- **Assignment of Project Contracts with Step-in / Substitution Rights**
- **Timely Financial Closure**
- **If same or more safeguards not feasible, insist on Full OR Limited Recourse**

# RISK ALLOCATION AND MITIGATION

## - Conversion option

### - On Default

- Deterrent for errant Promoters
- Correction for over leveraging

### - General

- Useful for rework/restructuring
- Upside sharing

# LOAN COVENANTS

## • **Pre-Commitment Conditions (PCCs)**

- **Critical Agreements/Contracts**
- **Critical Resource Arrangement**
- **Critical Clearances**

## • **Pre-Disbursement Conditions (PDCs)**

- **Financial Closure**
- **Up-front Promoters' Contribution**
- **Important approvals**
- **TRA**

# PRE-MATURE RELEASE OF FACILITIES

- **L/C issuance for CapEx**
- **Bridge Loan on inferior terms by 'other' Lenders**
- **Inadequate exchange of information/ NOCs**
- **Critical Approvals pending**
- **Sequencing of promoters' equity – 'Significant' proportion**



# WEAK CREDIT ADMINISTRATION

- **Frequency and Methodology of monitoring**

- **Low or No intervention when things go off-track**

- **Weak or short-sighted response to stress, Breaches and Slippages**



# UNDERLYING WEAKNESSES

- **Unhealthy race for Balance sheet growth**
- **Shrinking Domain knowledge and competencies**
- **Over reliance on Loan-arrangers**
- **Lack of common or co-ordinated approach among project participants**

# HOW TO GET-IT-RIGHT?

- **Develop competency pools**
- **Specialised Banks/Institutions for Lifecycle support**
- **Risk pooling / Sharing / Slicing / Participation**

# HOW TO GET-IT-RIGHT?

- **Collaborative, Well-knit Approach**
- **Timely monitoring and response**
- **Borrow outside help in Technical areas**
- **Support and Understanding from Regulators**

# CONCLUSION

- **Projects and Project Financing Critical for Economy**
- **Huge Diverse Learnings gathered over two decades**
- **Pool, Share and Put-to-use these Learnings**

# THANK YOU