Sources of Major Project Financing Capital – Three Very Different Options

By James Forrest, Managing Director of Affiliated Financing, LLC

Established corporations or those on a rapid growth curve, often need large sums of capital for financing new projects such as the expansion of space, financing inventory or the costs of a specific, highly profitable business opportunity. Unless you are seeking more than $100 million, or prepared for a public offering, your choices are few.

Simply stated, the options are usually a bank loan, private equity or *Monetization* financing.

- *Monetization Financing* of long term, minimum pay contracts provides maximum debt amortized over the life of the contract. Many Monetization private placements can be funded in less than 30 days from receipt of all the permits and paperwork.
- *Bank Loans* have a lower initial interest rate that floats against LIBOR, or is repriced every three or five years. Bank loans usually return 15% on all funds loaned by charging many points and fees, and may require additional checking account compensating balances. After the housing crisis of 2009, banks are required to prove 20% to 40% cash equity and personal guarantees from the borrowers. The process for approval may take nine months for the completion of all appraisals and paperwork.
- *Private Equity* investments are as they sound. You are selling a percentage of your business. The percentage is based on the PE firm's valuations, which are typically low and may be surprising. Valuations could be based on revenues per share, earnings per share, net assets, assets to shares outstanding (book value) or a combination. It is highly recommended that you have your accountant or attorney provide you with their valuations prior to meeting with a PE firm. However, depending on the PE firm, real value can be gained from the partners' expertise in your industry and willingness to help grow your business through introductions.

Monetization Financing

The best option, if you have investment grade corporate or governmental customers or sponsors, may be monetization of a multi-year *Take or Pay* or promise to pay contract. Some examples of this would be a city economic development department that is backing the building of a new plant, or expansion of an existing operation that will provide jobs and tax revenue. A corporation needing capital to provide products to the purchaser, for distribution or fulfillment of a larger contract, and the investment grade purchaser guaranteeing the debt issue to expedite delivery or lower costs.

Monetization Financing can be used for merger or acquisition, inprovements or increases to infrastructure, energy, monetization of financial instruments, capital goods financing, research and development or acquistion of tangible and intangible assets. Capital is provided by insurance companies, pension funds and institutional portfolios. Amounts available range from $20 million with no ceiling, depending on credit worthiness and need.

Monetization only works with irrevocable payment guarantees from investment grade payers. Essentially "factoring" long term promises of orders, basing the credit decision on the investment grade guarantor's balance sheet instead of the to-be-formed deNovo project's balance sheet.

If you are properly structured with a committed customer or sponsor, this could be your best course of action. Approval takes as little as a week, with the actual funding of a private placement generally taking between two to four weeks. There are no due diligence or post reporting requirements, oversight of corporate operations, fees, covenants or reporting to credit agencies. Maturities are flexible and can range in duration from one to 15 years, and can be deferred until the project is completed and assimilated into the business.

That's the good news.

To qualify you MUST have an investment grade rated guarantor (BAA+ Moodys or Standard & Poors), willing to contract for a multi-year *Take or Minimum Pay* agreement. Normally this is a municipality, state, Fortune 1000 corporation or other entity with a vested interest in the success of the project that undertake the obligation should the borrower default. Documents and documentation must be perfect! No exceptions!

Monetization is a form of *Structured Financing*. The repayment can be structured to skip any payments for three or four years to facilitate construction, "de-bugging" of operations and building a cash escrow cushion for a payment reserve to protect the payment guarantor. Reserves for a year's payment have been added to loan requests, and subordination of all insurance, real estate and equipment collateral. This is done to further protect guarantors from the unknown risks associated with a highly leveraged project.

Traditional Bank Financing

Bank financing is limited by credit and review committees, who judge a company's ability to adhere to a payment schedule. The committee's decision is also based on your corporation's credit history, outstanding obligations and net personal or business assets that can be liquidated should you default on the loan. This application process can often take three to nine months from a completed and accurate application to funding. At closing, if all documents are not perfect, funding will be delayed. And all bank financing requires the borrower to pay closing costs and cash equity of up to 30% of the loan amount, which will impact the cash available for the project.

CEO's and CFO's of successful corporations, often prefer increasing debt to giving up equity. However, depending on the size of the facility and the payment schedule, borrowers could see an immediate, negative impact on profitability and cash flow. There is a cost for exiting any fixed interest rate loan before the maturity. Further stipulations of the debt instrument may have severe penalties for late or early prepayment of the loan.

Private Equity

If taking on more debt is unattractive then Private Equity is the third option. Acquiring private equity financing typically takes six to 18 months. During this process, the firm may require payment of a retainer, due diligence expenses and a closing cost. Due diligence requires intense scrutiny by forensic accountants, operations consultants, market and human capital experts. Reports may suggest (meaning require) changes in operations, accounting procedures and personnel.

By the time the process is completed the opportunity may have vanished. Further, the instrument could be convertable debt. In this situation, corporate executives now must deal with interest payments they wanted to avoid, and the knowledge that control of the corporation could immediately vanish with the conversion of the loan to equity.

Private equity firms' executives are highly educated, experienced and ultra conservative. Should you be successful in receiving approval of private equity financing, you may discover your ownership is less than 30%. Your new "business partners" will control not only your board, but also executive decisions on day-to-day operations. Private equity is currently charging 300% interest ROR on the cash they invest.

A private equity relationship may become adversarial. The firm may decide that your company no longer fits their vision for their portfolio. They may see greater value in merging your and another of their portfolio companies to increase the value of both. In this scenario, you may have lost complete control or even employment. You may receive an offer to buy your stock. But that offer could be less than the value of your ownership prior to private equity financing.

If you are not fully prepared for this encounter and the ramifications of private equity funding, your dreams and career with the company could be doomed.

Your need and creditworthiness will determine which option is available and most suitable for your specific situation. But you need to be prepared when asking, prepared when receiving and prepared for the ramifications of your decision. There are "sharks in the water" looking for blood. Be prepared, be very, very prepared. It could be your blood.

About James Forrest, Managing Principal of Affiliated Financin,LLC

James Forrest is a financial professional with a broad 34-year financial services and marketing background, and reputation for getting things done.

In 1990, Mr. Forrest founded Affiliated Financing and incorporated in 1993. The firm arranged debt financing for growing small- and medium-sized businesses wanting to increase profits through new equipment, supplier discounts, buying inefficient competitors, low rate Industrial Revenue Bonds or buying or refinancing commercial real estate. These transactions included Asset Based Financing, Equipment Financing, Bank Loan Negotiation and Private Placements ranging from $45 million to $2 million.

In 2006, Affiliated began structuring private placements to fund portfolios of institutional investing sources that focus on monetization of Economic Development and other project financing.

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