Advisory Outlook

pwc

Recession-proof Financing

Securing capital for project development in a challenging environment

Securing equity and debt financing for projects can be a challenge at any time. Add the limitations imposed by the global economic slow-down and the goal can seem unachievable. The unrelenting downward pressure makes capital raising an uphill task for project sponsors in Nigeria, especially when investors who had previously sought exposure to Nigeria's high growth potential appear to be getting nervous. Now more than ever, obtaining financing for new projects require impeccable preparation before approaching investors. In our view, although unfavorable market conditions inevitably influence investment decisions, this is the best time to prepare worthwhile projects to attract financing.

Andrei Ugarov

Seyi Akinwale

More time should be spent on the preparatory phase of project development

Clearly, the investment environment in emerging markets and the approach of global financiers towards investing in these climes have changed dramatically in recent years. Although the impact of these changes are uneven across regions, investment opportunities within underperforming emerging economies are more likely to be subjected to very strict investment appraisal processes. Portfolio investors and strategic investors are looking seriously at opportunities in emerging markets, particularly in projects with a clear proposition and strong management team with the ability to deliver on growth potentials. Even in these challenging times, there are a lot of value opportunities in Nigeria; such opportunities will only attract a limited investor class with focus on long-term growth. More so, there are examples of success in countries in crisis and in sectors that were not the most attractive to investors that prove that it is possible to attract financing even during an economic downturn.

For the preparatory phase, it will be crucial for the project sponsor to adopt a thorough plan with a view to approaching the local and international capital markets in a regimented manner. A tightly managed preparatory phase will focus on the primary objective of "packaging" projects to demonstrate their underlying quality and to draw the attention of the investors and lenders. The project team, particularly owners i.e. sponsor and co-sponsors of potentially profitable projects, must be ready to apply basic marketing and sales principles. Importantly, the team must realise that local projects are competing for financing with other projects across the globe. In reality, projects developed locally can raise capital successfully as international ones, provided they comply with financiers' requirements. Only "obvious" proposals will compete successfully, especially when one considers the lack of track record of successful investments in most sectors and most countries in emerging markets. As such, the team must assume the role of international financiers and critique every component of the project under development such that they can anticipate and address the complex issues that would give financiers the comfort needed to fund the project. Although the opportunities are clear at times, the project information package should greatly stimulate the financier participation; this should be more pronounced than the project owners' enthusiasm.

In a volatile market as we see in Nigeria today, investor's negative perception could cause distracting "noise", making it harder for high quality projects and reputable companies to be heard. Ultimately, the success of any project is largely dependent on the amount of time and money invested by the project sponsors during the development phase. This should be complemented by the combined expertise of the sponsor's team, comprising of technical and transaction advisory experts - with the understanding of the continuously changing language and needs of financiers globally - towards presenting a compelling investment case to potential sources of financing. As a result of the reduced near-term interests in local projects and more stringent requirements for quality and transparency than traditionally sought by financiers, the right combination of these factors is imperative for a profitable project to secure funding. In most projects, the problem begins with lack of relevant information and a financing structure that shows how the project will repay its debts. These are elements critical to lenders and investors and must be part of the package. In many cases, in order to obtain "fresh" international financing for existing projects, the project owners must seek to restructure and reschedule existing domestic debts.

While project sponsors may elect to take full ownership at the inception phase, it is crucial to have assembled a project team at the early stages. A seasoned team will deliver impeccable project conceptualization and preparatory advice that will form the core of the development of any project. The timeline for achieving financial close for the capital raise will depend on the effectiveness of the project team in identifying inherent project risks and defining practical allocation strategies of such risks before progressing to fund raising.

Marketing investment opportunities and offer negotiation

As part of preparation towards approaching the market, project owners must form a deep understanding of the target financiers' profile and their 'sweet spots'. It is important to ascertain this prior to the commencement of marketing projects as an investment opportunity. The onus is on the transaction adviser to make sure that the unique requirement(s) of each potential financier is brought to the fore. In addition to this, the success of the capital raising will rely on marketing the investment opportunity only to the right audience. A well thought through information package will show that there is a market for products or services to be offered by the project, there is an experienced management team in place to run operations and that there is a structure in place that will insure good cash management, repayment of debt and good returns to the investors. A sound project team equipped with the perfect information package is well equipped to create competition among sources of financing, even in a recession.

When an agreement-in-principle to invest is made, the negotiations on terms and conditions begin. This is the riskiest period in the quest for project financing. The usually high risk of failure at this stage can be largely mitigated by the project team's ability to identify any "red-flags" that may exist and apply corrective measures prior to launching the marketing phase. At the very least, experienced transaction advisers should be able to anticipate and craft meaningful responses to all the issues that may be raised by the investors during negotiations. It will only be possible for the project owners to negotiate favorable terms and conditions when they have people on the team who thoroughly understand the process and have done it successfully in the past.

During negotiations, it is necessary to remain flexible and continuously process, analyze and filter information without losing a clear sight of achieving favorable financing. Market conditions can change significantly between the conceptualization and marketing phases leading to an extended negotiation period and eventually "deal fatigue". It is important to maintain strict adherence to the implementation plan and devise a sustainable means that ensures the project is presented to the sources of money in the most effective and coordinated way.

Must-haves for projects to attract financing in an economic recession

Project sponsors and management team that can be trusted to make the right decisions

During a recession, a financier's interest is primarily driven by the project's ability to deliver long term growth/value.

The best project companies are deemed to have an element of capital scarcity in their culture. These companies are keen on growing assets and efficiently pruning their operations to foster continuous improvement. This is in line with general investing belief that capital be distributed to shareholders if no opportunities to earn higher than the cost of equity exist.

Project sponsor's track record

The project sponsor and its co-sponsors must collectively portray quality track record and possess tested experience in successfully developing projects. It must be evident to financiers that lessons learned from such experiences have been taken into consideration prior to marketing the project. In addition, financiers need to be able to ensure uniformity in the project sponsor and co-sponsors' vison for the project. The project owners must demonstrate the ability to make good decisions quickly and articulate characteristics that sets them apart from other project owners seeking financing – often times for similar projects.

Clearly defined strategy

Projects with clearly defined strategies showing laid out steps on how this will in turn generate value for its shareholders, including financiers, increase investor confidence and generate participatory interests. Such strategies should include well thought out inputs on the total investment required, purpose for which required funding will be utilised, and expected results. The project team should focus financing needs on expansionary /growth strategies and not refinancing or working capital needs.

Knowledge of markets/ industries in which the project is being developed

Financiers – especially financial investors and foreign strategic partners – seek to collaborate with project sponsors that have a very good understanding of their industries and the markets they operate in.

In depth knowledge of the project's value drivers, how these will develop over the investment period, and ultimately result in the desired investment returns is essential in portraying a competitive advantage over other industry players. It is also critical for project owners to demonstrate a thorough understanding of the project's competitive landscape and differentiating factors of the project.

Returns commensurate to risk

Financiers' risk appetite differ, so would their expectations for return on investment. As the project is being prepared to compete for financing in the global capital markets, given Nigeria's high risk profile and other project and sector specific risk factors, the cost of capital for the different class of financiers may be relatively high at this time. The project package must therefore include a financial model that determines and articulates an optimal capital structure and commensurate returns for the different classes of financiers that the project can support. An experienced transaction adviser will be useful in providing the much required guidance in this regard.

Clear investor exit options

Projects that are able to show clear exit paths available to investors will attract funding from financiers who consider this a major input to their investment decision. The project sponsor and team may achieve this by developing business plans which clearly articulate the course to commercialisation such that potential investors can clearly visualise their alternatives towards monetising their interest in the project.

Consistency and predictability of the regulatory framework

This cuts across all industries in an economy and is, to a large extent, outside the project sponsor's control. Sources of funds need to perceive regulators as capable of putting in place and enforcing policies that transcend any given government. There is also the need to be able to trust the competency of policy makers to make the right decisions that will stir the economy out of a recession in the short-term.

Investors are often able to predict policy responses based on prevailing economic conditions and lose confidence when policies contrary to those considered the best solution are enforced. Inconsistent and highly unpredictable policies send unfavourable signals around the competency and independence of regulators.

Nigerian project owners should focus on quantifying the potential impact of such external risks and develop projects with "in-built" risk mitigating strategies for identified risks. Also, depending on the strategic importance of the project, an effective consultation of the government, its relevant agencies and global multilateral agencies towards achieving an investor-friendly risk mitigation framework may be considered.

In conclusion, sourcing project financing during a recession will be challenging. Project sponsors stand a better chance of success when preparatory work streams produce an investment case that portrays marketability of the project's products or services and credible structure that delivers good returns. It is imperative that investments in developing a solid investor package through collaborations with experienced advisors are made in the early stages. Project sponsors may consider the following questions to put their requirements in better context:

- Do you have the time and resources to dedicate to the search of financing?
- Do you need professionals who can validate and modify your project ideas?
- Do you know which financiers (local and foreign) would be interested in your project and why?
- Do you have access to these financiers? Also, how well do you know their investment psychology and requirements?
- Can you anticipate the obstacles that you are likely to encounter during project development and your search for financing?
- Can you show the structure of when and how the financing will be repaid?
- Can you negotiate the best possible deal for yourself by yourself?
- Do you feel that an experienced team with global networks would make a big difference?

About the authors

Andrei is a Partner and the leader of PwC's Corporate Finance unit. He can be contacted through andrei.ugarov@ng.pwc.com

Seyi is an Associate Director in PwC's Deals Advisory practice. He can be contacted on seyi.akinwale@ng.pwc.com