



INTRODUCTION TO PROJECT FINANCING

BY CA. PRACHI GOYAL

Sources of Funds

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graph TD; A[Sources of Funds] --> B[Debt]; A --> C[Equity];
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The diagram is a simple hierarchy. At the top is a green rectangular box with the text 'Sources of Funds'. A red line extends downwards from the bottom center of this box, then splits into two horizontal red lines. From the left end of the left horizontal line, a red line extends downwards to the top center of a red rectangular box labeled 'Debt'. Similarly, from the right end of the right horizontal line, a red line extends downwards to the top center of a red rectangular box labeled 'Equity'. The boxes have a slight 3D effect with shadows.

Debt

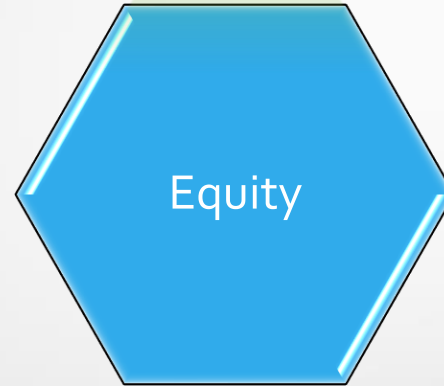
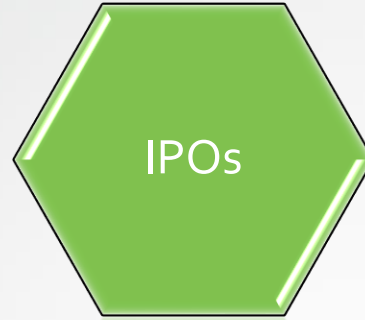
Equity

DEBT

Bank Financing

Inter-corporate deposits

Debentures



ELIGIBILITY NORMS FOR RAISING FUNDS THROUGH IPOs AS PRESCRIBED BY SEBI:

- a) Net tangible assets of at least Rs. 3 crore in each of the preceding three full years of which not more than 50% are held in monetary assets. However, the limit of 50% on monetary assets shall not be applicable in case the public offer is made entirely through offer for sale.
- b) Minimum of Rs. 15 crore as average pre-tax operating profit in at least three years of the immediately preceding five years.
- c) Net worth of at least Rs. 1 crore in each of the preceding three full years.
- d) If there has been a change in the company's name, at least 50% of the revenue for preceding one year should be from the new activity denoted by the new name
- e) The issue size should not exceed 5 times the pre-issue net worth

CONDITIONS FOR RAISING FUNDS THROUGH NSE EMERGE:

NSE Emerge is a platform for the best of emerging corporate to raise capital from Institutional investors and HNIs.

- Post issue paid up capital (face value) upto Rs.25 crore
- Track record of atleast 3 years
- Positive networth
- Operating profit from operations for at least any 2 out of 3 financial years

Particulars	Emerge	Main Board
IPO		
IPO Grading	Not mandatory	Mandatory
Post-issue paid-up-nCapital (Face Value)	less than Rs.25 crore	Not less than Rs.10 crore
Minimum number of allottees in the IPO	50	1000
Observations on DRHP	By the Exchange	By SEBI
IPO Underwriting	100% underwritten (15% on the books of the merchant banker)	Mandatory (Not reqd where 50% of issue offered for compulsory subscription by QIBs)
Market capitalization / Issue size	No restriction	No restriction
IPO Application size	Not less than Rs. 1 lakh	Rs.5,000 - Rs. 7,000
POST-ISSUE		
Reporting requirements (Audited a/c)	Half-yearly	Quarterly
Market Making	Mandatory	Not mandatory
Corporate governments requirements	Same as main board	Clause 49



VCs v/s. Angel Investors

- VCs generally using money pooled from investment companies, large corporations, and pension funds. Typically, VCs do not use their own money to invest in companies.
- Angel investors are more likely to invest in businesses that are just starting out. VCs tend to invest in businesses that are already established to reduce their risk of losing investments.
- Angel investors take more risks than venture capitalists.
- VCs invest more money into businesses than angel investors.



Crowdfunding v/s. IPOs

- **Lower Overhead.** As a rule, companies that are equity crowdfunded are not listed on any stock exchange and are therefore not obligated to comply with perpetual reporting requirements.
- While equity crowdfunding campaigns are not as liquid as IPOs
- Unlike IPOs, almost anybody who believes in a project can invest in an equity crowdfunding campaign, and the bar of entry is usually lowered down to just the campaigns investment minimum.
- Crowdfunding is done either to start-ups or growth-stage businesses and IPOs are to large established firms.



Trade Credit

Hire Purchase

Other Sources

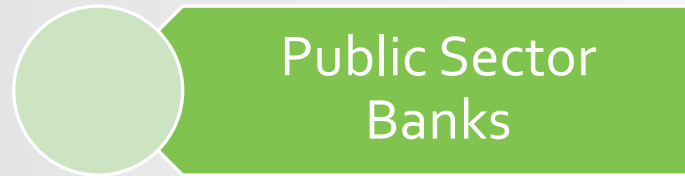
Bill Discounting/
Factoring

Subsidy

DEBT FINANCING

- BANKS
- NBFCs
- ARC- ASSET RECONSTRUCTION COMPANY

CLASSIFICATIONS OF BANKS



CLASSIFICATIONS OF BANKS



Majority stakes are
owned by the
Government

CLASSIFICATIONS OF BANKS



CLASSIFICATIONS OF BANKS

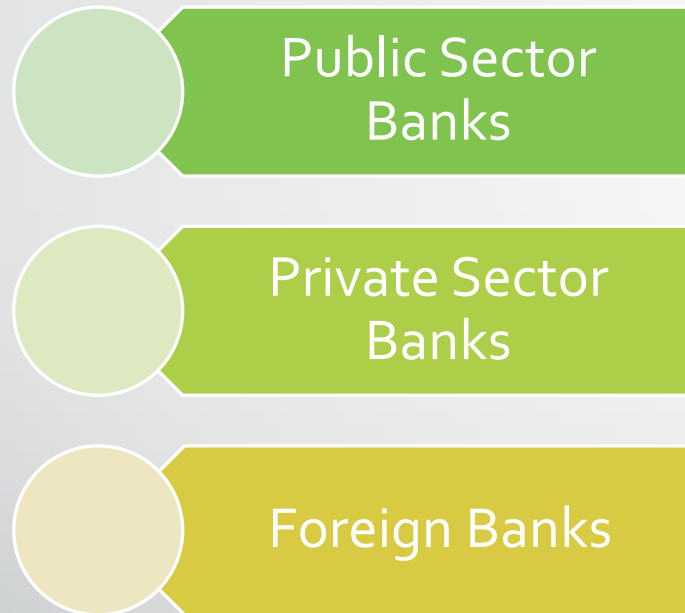


Public Sector
Banks



Majority stakes are
owned by a private
organization

CLASSIFICATIONS OF BANKS



CLASSIFICATIONS OF BANKS



Public Sector
Banks



Private Sector
Banks



Headquarters in foreign
countries and branches in
our country

CLASSIFICATIONS OF BANKS



Public Sector
Banks



Private Sector
Banks



Foreign Banks



Regional Rural
Banks

CLASSIFICATIONS OF BANKS



Public Sector
Banks



Private Sector
Banks



Foreign Banks



Concessional credit to
agriculture and rural
sector

CLASSIFICATIONS OF BANKS



Public Sector
Banks



Private Sector
Banks



Foreign Banks



Regional Rural
Banks



Local Area Banks

CLASSIFICATIONS OF BANKS



Public Sector
Banks



Private Sector
Banks



Foreign Banks



Regional Rural
Banks



-1996, private sector
-Profit oriented

CLASSIFICATIONS OF BANKS



Public Sector
Banks



Private Sector
Banks



Foreign Banks



Regional Rural
Banks



Local Area Banks



Co-operative
Banks

CLASSIFICATIONS OF BANKS



Public Sector
Banks



Private Sector
Banks




Foreign Banks



Regional Rural
Banks



Local Area Banks



- Cooperative Societies Act, 1912
- no-profit no-loss

CLASSIFICATIONS OF BANKS



Public Sector
Banks



Private Sector
Banks



Foreign Banks




Regional Rural
Banks



Local Area Banks



Co-operative
Banks



Specialized Banks

CLASSIFICATIONS OF BANKS



Public Sector
Banks



Private Sector
Banks



Foreign Banks



Regional Rural
Banks



Local Area Banks



Co-operative
Banks



- SIDBI
- EXIM
- NABARD

CLASSIFICATIONS OF BANKS



Public Sector
Banks



Private Sector
Banks



Foreign Banks




Regional Rural
Banks




Local Area Banks



Co-operative
Banks



Specialized Banks



Small Finance
Banks

CLASSIFICATIONS OF BANKS



Public Sector
Banks



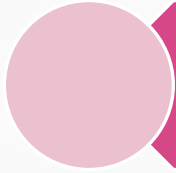
Private Sector
Banks




Foreign Banks




Regional Rural
Banks




Local Area Banks



Co-operative Banks



Specialized Banks



Micro industries, small
farmers, and the
unorganized sector

BASIS FOR COMPARISON	NBFC	BANK
Meaning	An NBFC is a company that provides banking services to people without holding a bank license.	Bank is a government authorized financial intermediary that aims at providing banking services to the general public.
Incorporated under	Companies Act 1956	Banking Regulation Act, 1949
Demand Deposit	Not Accepted	Accepted
Foreign Investment	Allowed up to 100%	Allowed up to 74% for private sector banks
Payment and Settlement system	Not a part of system.	Integral part of the system.
Maintenance of Reserve Ratios	Not required	Compulsory
Deposit insurance	Not available	Available

BASIS FOR COMPARISON	NBFC	BANK
Credit creation	NBFC do not create credit.	Banks create credit.
Transaction services	Not provided by NBFC.	Provided by banks.

ASSET RECONSTRUCTION COMPANY

- An **Asset Reconstruction Company** is a specialized financial institution that buys the NPAs or bad assets from banks and financial institutions so that the latter can clean up their balance sheets. Or in other words, ARCs are in the business of buying bad loans from banks.

BANKING FACILITIES

Fund based

- Where the borrower get actual money
- CC, OD, TL

Non-Fund based

- Nature of promises made by Banks in favour of a third party to provide monetary compensation
- BG, LC

FUND BASED LIMIT

CASH CREDIT

- Working capital limit provided for the day-to-day requirements
- Provided for 1 year and is supposed to be renewed every year
- Against the stocks, work-in-progress, finished goods and the receivables of the company
- Stock Statement

Method of Lending- Nayak Committee

- WC Limit = 20% of their projected annual turnover
- Margin of 5% of the annual turnover

Method of Lending- Tandon Committee

Maximum Permissible Bank Financing

- Method I

Margin = 25% of Working Capital Gap (CA – CL excluding bank borrowings)

Minimum Current Ratio – 1.17:1

- Method II

Margin = 25% of Total Current Assets

Minimum Current Ratio – 1.33:1

Method of Lending- Tandon Committee

Maximum Permissible Bank Financing

- Method III

Margin = Core current assets (Fixed Current assets) and 25% of the balance of the current assets.

The remaining of the working capital gap can be met from bank borrowings.

STOCK STATEMENT

Particulars	Quantity	Rate	Value	Margin*	Eligibility
Stock					
- Raw Material			XXX		
- Work in progress			XXX		
- Finished Goods			XXX		
Total value of stock			XXX		
Less: Creditors			XXX		
Paid stock			XXX	25%	75%
Receivables (90 days-120 days)			XXX	40%	60%
Total Eligibility					XXX

*the margins may differ from case to case and bank to bank.

ILLUSTRATION

Particulars	Quantity	Rate	Value	Margin*	Eligibility
Stock					
- Raw Material			XXX		
- Work in progress			XXX		
- Finished Goods			XXX		
Total value of stock			50		
Less: Creditors			10		
Paid stock			40	10	30
Receivables			30	12	18
Total Eligibility					48

FUND BASED LIMIT

OVERDRAFT

- Short-term fund-based limit
- Provided for 1 year and is supposed to be renewed after every year
- Amount = 150-200% of value of immovable property
- No need of Stock Statement
- Assessment of OD limit is simpler than CC limit.

FUND BASED LIMIT

TERM LOAN

- Long-term fund-based limit
- Fixed amount, Fixed interest rate, Fixed repayment
- Purpose- purchase of assets/ construction
- Fixed EMI
- Moratorium period

TYPES OF TERM LOANS

MSME FUNDING

Revised Classification applicable w.e.f 1 July 2020			
Composite Criteria: Investment in Plant & Machinery/equipment and Annual Turnover			
Classify	Micro	Small	Medium
Manufacturing Enterprises and Enterprises rendering Services	Investment in Plant and Machinery or Equipment: Not more than INR 1 cr and Annual Turnover; not more than INR 5 cr	Investment in Plant and Machinery or Equipment: Not more than INR 10 cr and Annual Turnover; not more than INR 50 cr	Investment in Plant and Machinery or Equipment: Not more than INR 50 cr and Annual Turnover; not more than INR 250 cr

TYPES OF TERM LOANS

LEASE RENTAL DISCOUNTING (LRD)

- Quantum
 - Based on the discounted value of future rentals
 - 60 to 80% of underlying property value
- Longer Tenure
- Repayment Mode
- Security- Rental (primary) and property (collateral)
- Competitive ROI

TYPES OF TERM LOANS

RETAIL BUSINESS

- House Loan
- Education Loans
- Vehicle or Auto Loans

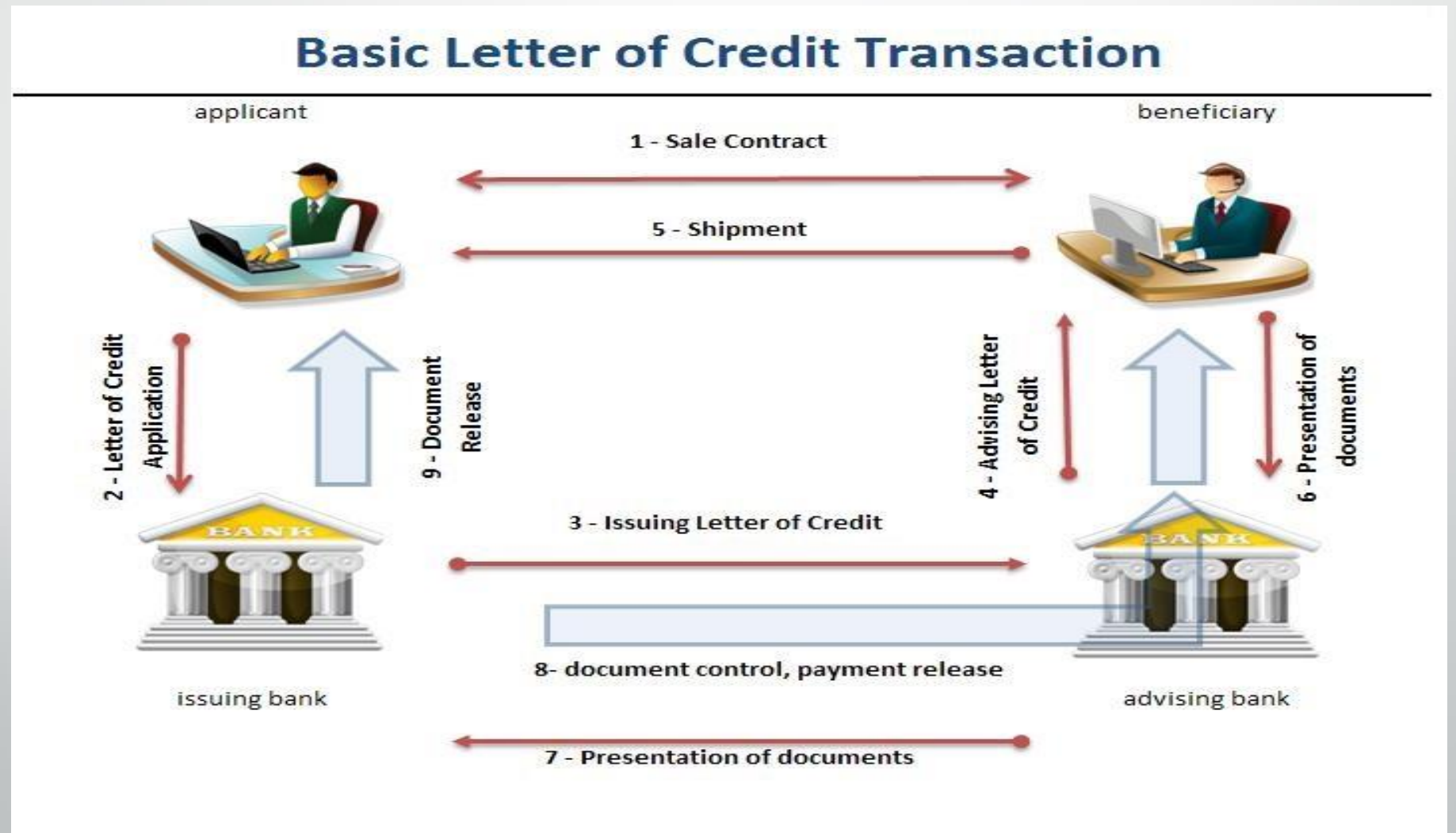
TYPES OF TERM LOANS

UNSECURED LOANS

- Government Schemes like CGTSME, Mudra loans
- Personal Loans
- Business Loans

NON-FUND BASED LIMIT

LETTER OF CREDIT (LC)- Demand/ Usance



NON-FUND BASED LIMIT

BANK GUARANTEE (BG)

TYPES OF BG

- Financial Guarantees

A financial guarantee is a type of promise given by a guarantor to take responsibility for the borrower in the case of default in payments to the lender or investor.

- Performance Guarantees

A Performance Guarantee is a contractors promise to complete the project undertaken. To further elaborate, a Performance Guarantee is a document that legally confirms that the contractor will complete the contract that is undertaken.

PROJECT FINANCING- MANUFACTURING UNIT



REQUISITES OF PROJECT FINANCING



File

Financials

RATIOS

Current Ratio 1.33:1

Measure of business liquidity

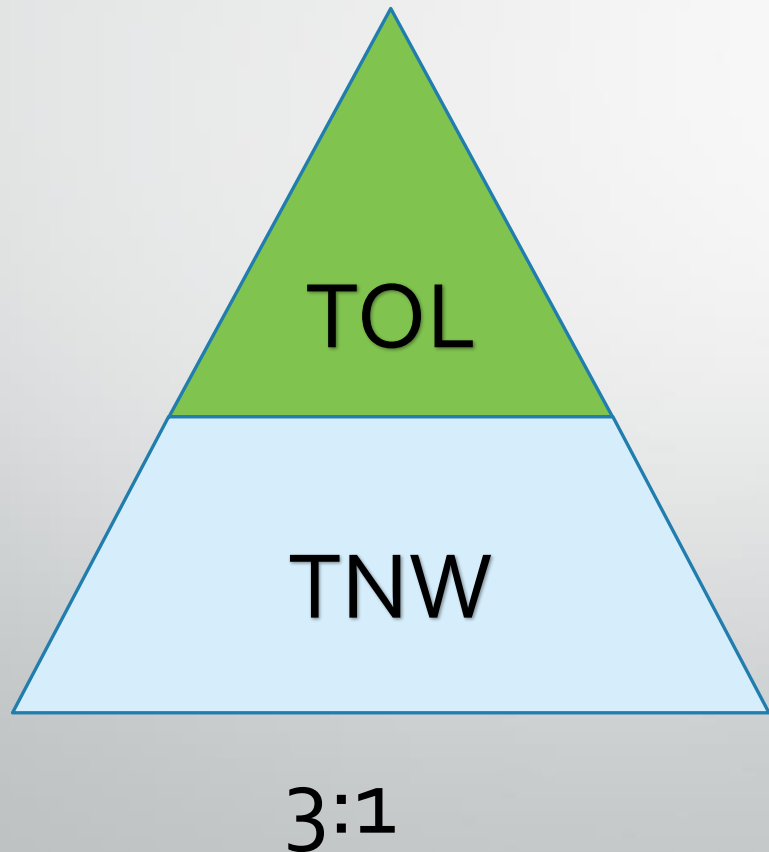
Current
Assets

/

Current
Liabilities

RATIOS

Gearing Ratio



It is a measure of a company's financial leverage, giving an accurate picture of the business's *reliance on debt*.

Low Ratio* = Good levels of promoter's stake in business

High Ratio = Low levels of promoter's stake in business - Risky Business

RATIOS



Debt to Equity Ratio Formula =
2:1



Total liabilities

Shareholders' Equity



RATIOS

Debt Service Coverage Ratio (DSCR)

$$\text{Debt Service Coverage Ratio} = \frac{\text{Net Operating Income}}{\text{Debt Service}^*}$$

1.75

* Debt Service = Interest & Lease Payments + Principal Repayments

RATIOS

IRR

INTERNAL RATE OF RETURN

$$0 = NPV = \sum_{n=0}^N \frac{CF_n}{(1+IRR)^n}$$

RATIOS

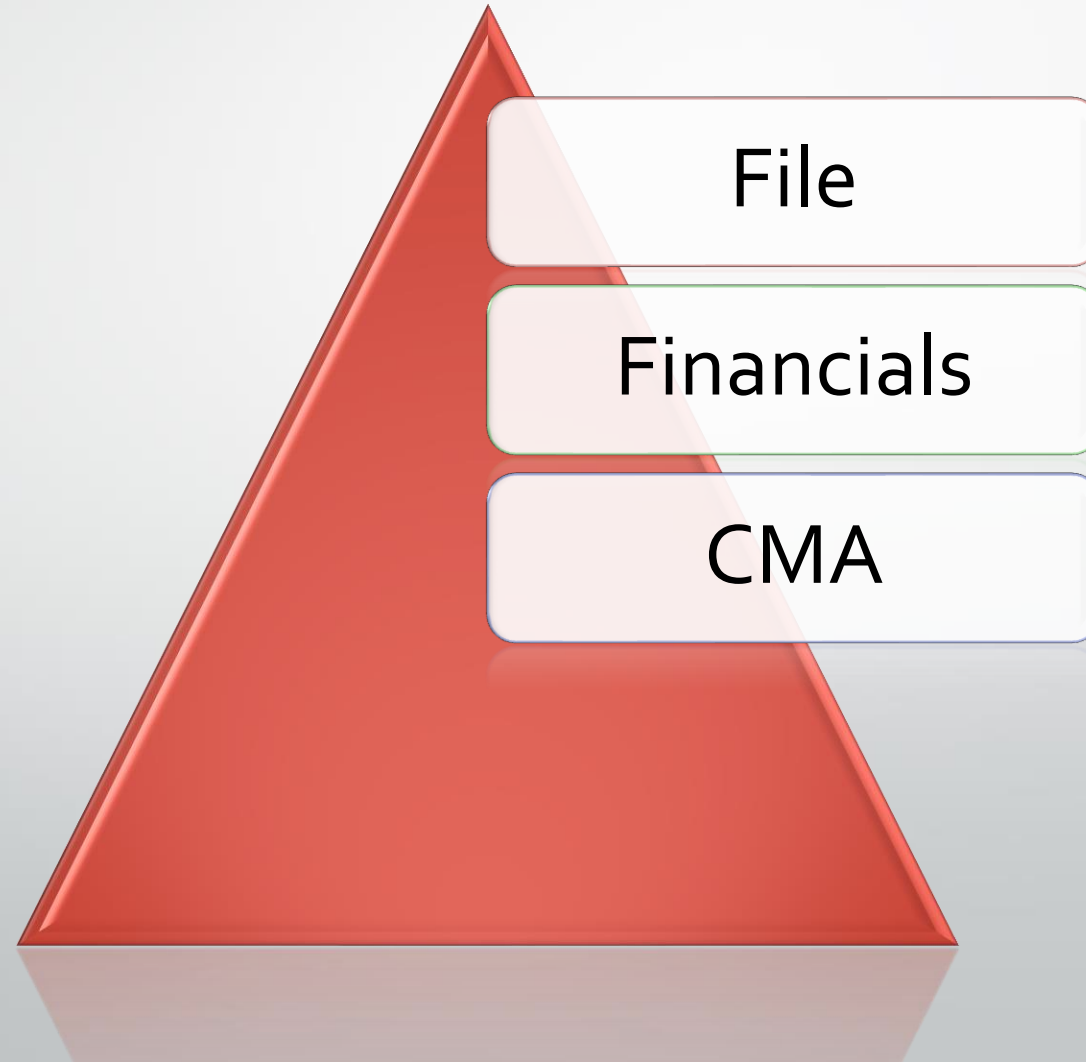
$$\text{Interest Coverage Ratio} = \frac{\text{Earnings before Interest and Taxes (EBIT)}}{\text{Interest Expense}}$$

Measures the number of times a company can *make interest payments* on its debt from its earnings.

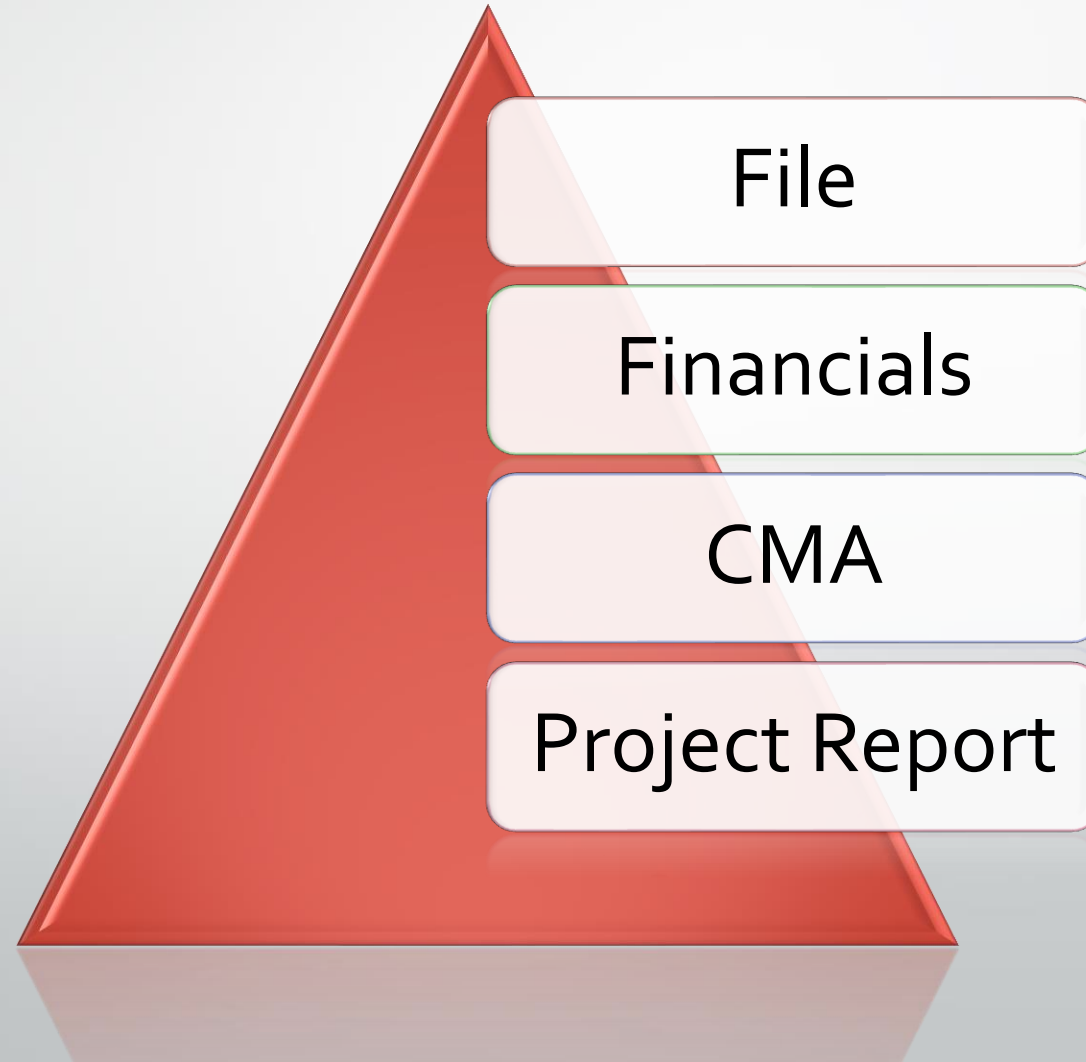
High Ratio (>2) is considered comfortable for the lenders.

Low Ratio (<1) implies trouble in honoring interest payments on time.

REQUISITES OF PROJECT FINANCING



REQUISITES OF PROJECT FINANCING





OTHER REPORTS/ DOCUMENTS REQUIRED

LEGAL SEARCH REPORT

- Primary Security
- Collateral Security



OTHER REPORTS/ DOCUMENTS REQUIRED

VALUATION REPORT

- Market Value
- Realizable Value (90%)
- Distress Sale Value (70-75%)

OTHER REPORTS/ DOCUMENTS REQUIRED

TEV REPORT

- **Techno Economic Viability (TEV)** study
- evaluating the technical and financial information
- technological feasibility and economic viability
- Normally required for case above **Rs.25** crores

OTHER REPORTS/ DOCUMENTS REQUIRED

LIE REPORT

- **Lender's Independent Engineer's (LIE) Report**
- Technical Due Diligence Report prepared by an Independent Engineer
- Reviews the technical inputs (i.e. output, efficiency, O&M expenses, availability, etc.)
- Requirements for big size projects only

OTHER REPORTS/ DOCUMENTS REQUIRED

EXTERNAL CREDIT RATING

- Qualitative & Quantitative assessment of the probability of default on payment of interest and principal on a debt instrument
- Alpha-numeric symbol, for e.g. AAA, AA+, A-, etc.
- Based on a comprehensive evaluation of the strengths and weaknesses of the company fundamentals including financials along with an in-depth study of the industry as well as macroeconomic, regulatory and political environment.
- Of all factors influencing the credit rating, Financial risk carries the highest weightage. (Others - industry risk, government policy, market position, operational efficiency & management evaluation)
- Why is it important?
- India ratings, CRISIL, CARE, ICRA etc.

OTHER REPORTS/ DOCUMENTS REQUIRED

CIBIL/ CRILC

- Credit Bureau or Credit Information Company
- Maintains the records of all the credit-related activities
- It provides data to the banks and other lenders to quickly and efficiently filter the loan applications
- 3 digit number

OTHER REPORTS/ DOCUMENTS REQUIRED

ROC SEARCH REPORT

Whole history of the company with respect to

- Basic details
- Charge created/ modified/ satisfied of all the past/ present loans
- Shareholding pattern of the company
- Directors etc.

CONCLUSION

- Trading Sector
- Infrastructure projects
- Tourism Industry
- Road projects
- Contractors
- Hospitals
- Lease Rental Discounting
- Warehousing
- Cold Storage
- Real Estate
- Food Industry
- Education Sector
- Agriculture Sector
- Professionals



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