

The Strategy of International Project Financing - Syllabus – Fall 2008

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This course is intended for future finance and legal professionals seeking a 'practitioner's' grasp of Project Financing (PF) and for future executives who wish to understand how PF can help in the execution of business strategy. As such, the course focuses on the reasons why borrowers employ PF and critically examines whether such uses create or destroy value.

The course is largely taught from the borrower's perspective. This viewpoint is fundamental because it is the borrower who must decide whether PF has a role to play in the execution of business strategy. Students interested in a Lender's perspective will benefit, however, from a deeper understanding of borrowers' motives, their ideas on how PF creates value, and from insight into how borrowers compute PF economics.

Course content consists of lecture material, readings and most importantly case studies of recent project financings. Students will form teams and present at least one case study to the class during the semester. In total, eleven cases will be read and ten cases presented for class discussion

Most of the case studies are written by the Professor and reflect transactions with which he is personally familiar. The case studies are designed to display dilemmas that arise when PF is employed as part of a broader business strategy. In this way, the nexus between the correct use of PF and success or failure in business strategy will be illustrated.

The Fall 2008 course will give special attention to the preparation and analysis of the case studies. Lecture material pertinent to each case study will be presented in class one week in advance. The instructor will also introduce the case study at the end of that class, emphasizing particular issues each team will need to address. Teams are encouraged to discuss the case with the instructor during the week prior to their presentation. Case presentations will then be made at the beginning of class the following week.

Presentations should be no more than 8 PowerPoint slides, not including table of contents. Teams should minimize inclusion of background material, as the whole class will have been required to read the case. Teams should follow the methodology outlined by the instructor during the first class, and will be graded in part on how well they do so.

The instructor will then present an assessment of each teams' case presentation. He will also conclude each case discussion by highlighting other issues and teaching points of note. The second portion of each class will then cover material pertinent to the following week's case study.

The first part of the course will cover PF fundamentals and economics. Particular attention will be devoted to the legal and practical aspects of 'non-recourse' and 'limited recourse' financing. Specific topics will include the theory of project financing, the creditworthiness of project loans, sources of PF funding, how to compute 'leveraged economics', and the impact of PF on project economics.

Part 2 of the course will focus on the specific strategies that employ PF, and will examine cases which illustrate the factors which lead to either successful deployment of PF or to value destruction. Particular attention will be given to the role of PF in strategies involving joint ventures, its role in infrastructure projects involving 'public/private' partnerships, and to using PF to allocate and mitigate project risk. A final class will focus on a new topic, the use of PF in leveraged buyouts of existing businesses.

It is anticipated that one or more guest speakers will join us, one either from ExxonMobil and/or Societe Generale Bank. They will critique case presentations and discuss their own views on specific PF issues.

The Strategy of International Project Financing is intended to be taken in conjunction with "*Tactics and Techniques of Project Financing*". This second course will focus on how to design a Project loan, negotiate its terms, and place the financing in the debt markets. While the two course sequence is recommended for those who seek a mastery of PF, each course is designed to stand on its own. It is recommended, but not essential to begin with the Strategy course and follow up with Tactics & Techniques.

Course Readings and Grading

Course readings will consist of selections from **Project Financing, Asset-Based Financial Engineering**, Second Edition (PF Abfe) by John D. Finnerty, John Wiley & Sons, Inc, 1996, and materials/articles provided by the Professor. In addition, students will be expected to read the assigned Case Studies. Two of the case studies, "The Chad-Cameroon Petroleum Development and Pipeline Project", and "Petrolera Zuata, Petrozuata C.A." will be available in the bookstore or can be acquired online from HBS; the instructor will provide the remaining cases via WebCt. Lecture notes will also be placed on WebCt following each class, so that students can review the material in conjunction with the assigned case.

Students will be assigned and graded on at least one case study, which will count for 25% of the course grade. A mid-term (25%), final exam (40%) and class participation (10%) will compose the remainder of the student's grade. Depending upon the midterm exam results, the final exam may be a take-home case study.

Questions or messages may be sent to me via e-mail at svarbogast@comcast.net or svarbogast@uh.edu. In time critical situations, the home e-mail address is probably a better bet. Alternatively, I can be reached at 713 898-2636.

The course topics, readings and case studies are outlined below.

Class will begin at 6pm on Tuesday, August 26.

Good Luck!

The Strategy of Project Financing
Course Outline

Part 1

Date	Topic	Case Study Presentation	Readings
<p><u>Class I</u> August 26</p>	<p style="text-align: center;"><u>Introduction & Overview</u></p> <ul style="list-style-type: none"> • Course Overview: 1) PF Fundamentals, 2) PF Strategy and Economics, 3) PF Strategies ‘In action’ • Definition of Project Financing and Historical Development • Overview of Reasons Sponsors Consider PF • Lenders Objectives • PF Issues Borrowers and Lenders negotiate • Introduction to Case Study 1 - on changes in PF as the financing technique matured 		<p>Read:</p> <p>PF Abfe: pp. 1-12, 394 - 397</p>
<p><u>Class II</u> September 2</p>	<p style="text-align: center;"><u>The Project Finance Credit Problem</u></p> <ul style="list-style-type: none"> • How to attract financing for a Project that doesn't exist? • Types of Projects that are suitable • Completion credit risk and support • Operating period credit risk & support • Typical Lender Credit Benchmarks • Non-Recourse vs. Limited Recourse Financing • Introduction to Case Study 2 – on whether a PF is really ‘non-recourse’ 	<p style="text-align: center;"><u>Case Study 1 Presentation</u></p> <p style="text-align: center;"><i>"Didn't You Used to Be Project Financing"</i></p>	<p>Read:</p> <p>PF Abfe: pp. 88-97 and Case Study 1</p>
<p><u>Class III</u> September 9</p>	<p style="text-align: center;"><u>Sources of Project Finance Funding</u></p> <ul style="list-style-type: none"> • Commercial Bank Market • Private Placement Market • Rule 144A Bond Market • Export Credit Agencies • Multilateral Agencies • Comparison of Terms and Conditions • Islamic Finance • Implications for Borrowers • Introduction to Case Study 3 – on choices/challenges in sourcing PF in different markets 	<p style="text-align: center;"><u>Case Study 2 Presentation</u></p> <p style="text-align: center;"><i>H.K. Genco Ltd. (A)</i></p>	<p>Read:</p> <p>PF Abfe pp. 209-210, 214-226, 231-237 and</p> <p>Case Study 2</p>
<p><u>Class IV</u> September 16</p>	<p style="text-align: center;"><u>Business Strategy & Project Financing</u></p> <ul style="list-style-type: none"> • Introduction to Corporate Strategy • Investment Strategies that Often Employ PF <ul style="list-style-type: none"> - Growth in Capital Intensive industries; accessing scarce resources - High ROE in Regulated Industries & in Low Risk Assets - Speculative Acquisition; growth in High Risk businesses or locations • Contribution of PF to each Strategy <ul style="list-style-type: none"> - Map of actual PF rationales vs. contributions to Strategy • PF's critical success factors & economics; potential Pitfalls & Misuse of PF 	<p style="text-align: center;"><u>Case Study 3 Presentation</u></p> <p style="text-align: center;"><i>Petrolera Zuata, Petrozuata C.A</i></p>	<p>Read:</p> <p>PF Abfe, pp.22-28 and Case Study 3</p>

<p><u>Class V</u> September 23</p>	<p><u>Framing the Economics of PF</u></p> <ul style="list-style-type: none"> • Actual PF Objectives of Sponsors • Investment Economics & Financing Economics • How to do 'Leveraged Economics' • When to do financing economics vs. when to adjust Project Economics • Defining the Opportunity Cost of PF: Cost of Capital vs. Cost of Debt • Centralized Financing - the usual alternative; "Non-economic" costs of PF • Capturing PF costs in Project Economics (I) - the High Cost Financing Debit • PF economics as a Financing Strategy 		<p>Read: Teaching Note I on PF Project Economics</p>
<p><u>Class VI</u> September 30</p>	<p><u>When Does Project Financing Make Economic Sense?</u></p> <ul style="list-style-type: none"> • <i>Review of PF Economics and Problem Set 1</i> • Sponsor Economics when You Don't Have Money • Competing using 'Leveraged Economics' - Non-recourse and recourse financing • Economics of using PF to 'Stretch the Corporate Balance Sheet' • Economics when Political Risk discourages investment or interferes with operations • Economics when your Partner Doesn't Have Money • Capturing PF costs in Project Economics (II) - the 'Cost of Carry' • Bank Economics of PF Lending 		<p>Read: Teaching Note II on PF Economics; Do Problem Set 1 provided by Professor</p>
<p><u>Class VII</u> October 7</p>	<p><u>Midterm Preparation</u></p> <ul style="list-style-type: none"> • Review of PF Economics and Problem Set 2 • Summary of Key Part 1 Teaching Points • Midterm Exam Preview • Introduction to Case Study 4 - on corporate strategic planning and financial constraints 		<p>Do Problem Set 2</p>
<p>October 14</p>	<p><u>Midterm Exam</u></p>		

Part 2

<p><u>Class VIII</u> October 21</p>	<p><u>Project Financing to Expand Debt Capacity</u></p> <ul style="list-style-type: none"> • Review of Midterm Exam • The theory of 'Off-Balance Sheet Financing' • Accounting Treatment of Project Financing – then and now • Rating Agency Treatment of Project Financing • Does "Off-Balance Sheet" PF exist? • Introduction to Case Study 5: on the attractions, challenges and economics of using PF to 'expand debt capacity' 	<p><u>Case Study 4 Presentation</u></p> <p><i>Missol Petroleum Considers Investment Policy and Project Financing</i></p>	<p>Read: PF Abfe, 28-30 and Case Study 4</p>
<p><u>Class IX</u> October 28</p>	<p><u>Project Financing to maximize use of available capital, distribute risk and fund Growth</u></p> <ul style="list-style-type: none"> • Can high growth strategies based upon PF succeed? • The critical roles of the Business model and risk allocation • Case study: A look at Indiantown Power vs. Calpine • Recognizing the limits of PF-based high growth • Allocation of risk & credit support among project, sponsors, suppliers, customers and lenders • Introduction to Case Study 6: promise and pitfalls of complex PF structures using 'OPM' 	<p><u>Case Study 5 Presentation</u></p> <p><i>Terrasia Aromatics Project (A) (guest from ExxonMobil may critique presentation)</i></p>	<p>Read: PF Abfe, 288-296 and Case Study 5</p>
<p><u>Class X</u> November 4</p>	<p><u>PF and The Problems of Partners</u></p> <ul style="list-style-type: none"> • Partners without Money or unwilling to make it available • Forms of 'Imposition', Over-financing & 'Carrying' a Partner • The Risks of Carrying a Partner • How Project Financing Can Minimize 'Carry' • Credit Leakage to Weaker Partner • When Partners are not strategically aligned - PF terms as proxy for Partner disputes • How PF can reconcile or overcome Partner non-alignment 	<p><u>Case Study 6 Presentation</u></p> <p><i>The Euro Disneyland Project</i></p>	<p>Read: Case Study 6, PF Abfe, pp. 338-367 (Euro Disneyland Case)</p>

<p><u>Class XI</u> November 11</p>	<p><u>Project Financing Infrastructure via Public/Private Partnerships (PPPs)</u></p> <ul style="list-style-type: none"> • Characteristics of Infrastructure Projects that are suitable for PF • Reasons why Government prefer PPPs and PF • Nature and forms of Public/Private Partnerships • Potential Pitfalls of PPPs & PF • Discussion of Tribasa Toll Road Project Case, including structural features, financing projections, outcome and restructuring measures • Introduction to Case Study 7: on use of PF to resolve partner issues within a JV 		<p>Read: Abfe, pp. 278-287 and Tribasa Toll Road Project Case in Abfe, pp. 319-337</p>
<p><u>Class XII</u> November 18</p>	<p><u>The Nature of Project Political Risk</u></p> <ul style="list-style-type: none"> • The Usual Suspects: Expropriation, Nationalization, Convertibility, and Civil Strife • Historical Perspective: Expropriation of the Middle East Oil Concessions, 1971-75 • Change in Terms and Creeping Expropriation • National Partner Risk; Infrastructure & Supply Risk • Predicting & Quantifying Political Risk • Classical Use of PF to Hedge Political Risk • PF into financing markets that will take political risk • Introduction to Case Study 8: on measuring and pricing Project Political Risk and targeting 	<p><u>Case Study 7 presentation</u> Ban Diego LNG</p>	<p>Read: PF Abfe, 273-277 and Case Study 7</p>
<p><u>Class XIII</u> November 25</p>	<p><u>Using Project Financing to Hedge Today's Political Risk</u></p> <ul style="list-style-type: none"> • New Forms of Political Risk - Project in Very Poor Countries; Potentially Failed States • New Options for Hedging Political Risk: ECA's, MLA's, Political Risk Insurance • PF and: 1) Stake Reduction; 2) Deterrence; & 3) Deal Term Definition/Clarification • PF and Structural Constraints on Host Government options • Integrated Strategy for Hedging Political Risk via PF • Structuring for Islamic Financing • Introduction to Case Study 9: on using PF to mitigate catastrophic political risks 	<p><u>Case Study 8 Presentation</u> Take Project and Political Risk in Djibouti?</p>	<p>Read: PF Abfe, pp. 81-85 and Case Study 8</p>

<p><u>Class XIV</u> December 2</p>	<p><u>Business Strategy, Acquisition and PF</u></p> <ul style="list-style-type: none"> • Role of Acquisition in Business Strategy: <ul style="list-style-type: none"> - for mature companies - for financial investors, e.g. private equity • How acquisition financial objectives and challenges vary by investor <ul style="list-style-type: none"> - use of financing to discipline existing businesses - valuing the crucial 'right to walk away' • Characteristics of PF in leveraged buyouts • Introduction to Case Study 10: on the benefits and costs of 'stand-alone' financing for Acquisitions <p>Final Exam Preview</p>	<p><u>Case Study 9</u> <u>Presentation</u></p> <p><i>Chad-Cameroon Pipeline</i></p>	<p>Read:</p> <p>Case Study 9,</p> <p>Case Study 10: <i>Financing the Acquisition of Kemica Pty.</i></p>
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Final Words:

Academic Honesty:

The University of Houston Academic Honesty Policy is strictly enforced by the C. T. Bauer College of Business. No violations of this policy will be tolerated in this course. A discussion of the policy is included in the University of Houston Student Handbook, <http://www.uh.edu/dos/hdbk/acad/achonpol.html>. Students are expected to be familiar with this policy.

Accommodations for Students with Disabilities:

The C. T. Bauer College of Business would like to help students who have disabilities achieve their highest potential. To this end, in order to receive academic accommodations, students must register with the Center for Students with Disabilities (CSD) (telephone 713-743-5400), and present approved accommodation documentation to their instructors in a timely manner.