

Project financing

Global Mining Company



In this case study the customer is one of the world's largest base metal mining companies with mining, ore-processing and refining operations on most continents. Annual revenues are roughly \$37 billion.

Situation

The company, has grown through a combination of organic growth, mine development and acquisitions. As in any large organization there are various processes and ways that things get done

in its varied operations. One consistent requirement however is for equipment and system reliability. It is at the heart of creating revenue through production output, quality of that output, safety and environmental performance. Reliable assets run longer and produce more. Reliable assets are in the “normal” state, functioning as desired, so they have lower risks to safety of operators and maintainers, and to the environment.

One of the company's operating divisions, comprising some 14 operations, was formed as a result of an acquisition some years ago. The acquired company had itself acquired others prior to that. Practices in maintenance were varied and delivering variable reliability results. They had formed a reliability group at the division level, comprising both division level and site level engineers and technologists. They were seeking to improve reliability to increase output and lower their unit costs. The challenge they faced was that base metals prices were largely quite low and funding for the initiative was tight. They needed to have some quick wins and get the initiative paying for itself quickly (i.e.: within 6 months).

Solution

Achieving quick wins in the project was not going to be difficult. Maintenance performance metrics revealed that there was much room for improvement. Although not measured at the outset, reliability being achieved, had to be disappointing. Finding problems with relatively quick solutions was not going to be difficult, sustaining them, given the years of mediocre practices that had to be changed, would be the bigger challenge. Financing it all was also a challenge – our team was bidding against other firms (mostly engineering firms) who were known to have lower rates. Lower rates, imply, but don't promise, lower costs and they sure don't promise results. Like us they had plenty of mining industry experience, but our competitors have tended to focus on engineering projects, not on maintenance and reliability. In this race, we were the dark horse. Niche players with a great track record of getting results in maintenance and reliability, but higher rates in a field where many assume that engineering firms should have some expertise. We knew differently, but we were not sure the customer would know that.

Our technical approach was already proven elsewhere. We had a great deal of confidence and even forecasted results exceeding the customer's stated goals. We know this would be a big win for them. However, in a bidding situation run by buyers and accountants, we need to get past the perception that we'd be high cost because our rates were higher than our competitors.

We emphasized value for the money. Yes, our rates were higher, but we could confidently promise more than was required in terms of asset performance, and we were willing to accept some risk and put some skin in the game. The project was going to be a big one, roughly \$20 million and payback annually once it was completed would be about 5 times that amount. Returns on it would have been massive. Given the metrics we had at the outset, we knew we could have it paying for itself quickly and provide a massive return on the investment and future returns on the assets due to improved performance.

That situation, where we find big returns quickly, is actually quite common, especially if the performance has been very poor. The numbers become difficult to believe by many executives, and that is because so few of them have any background in maintenance and reliability. They don't know what they don't know, but once it is pointed out to them, they do see the high value that is possible.

In addition to the added top line improvements, the needed cost reductions and then some, we engaged a financing firm to help with customer cash flow during and after the project. We needed to cover costs, but saw the potential to earn more than our regular fees if the gains we had forecast were achieved. A small slice of those gains would have made us very happy. Part of our proposal was to accept lower fees throughout the project execution (enough to cover our costs) and take a part of the gain later.

The customer was "credit worthy" and therefore easily eligible for loans, lines of credit, leases, etc. We anticipated that the project would be cash positive within a few months and paying for itself from that point onwards. Within the first year, it would probably have already paid for the project. That is something we find quite often when performance is low – the returns exceed 100% in the first year.

The financing was set up like a lease, although there was no equipment or asset that could be seized if the customer defaulted. It worked like a line of credit. Our efforts and other project expenses incurred would be paid from the funding as incurred. The balance would increase. Since payback on the effort wasn't immediate, first payments against the balance were deferred for six months. By then the project was cash flow positive. The amount of the payments to bring the balance down was kept below the estimated positive cash flow that was now growing from the project's results. It was now paying for itself. As the project progresses, the amount of cash flow generated grew and the customer had the option of either keeping payments steady or increasing them.

Gains were part of the project metrics. Finance had to track cash flows anyway, in order to determine how much of the line of credit they'd pay each month, so the customer already had a handle on what the project was earning for them. Those accumulated throughout the term of the project and at the end we had earned a small slice of those gains (in the customer's eyes) and for that, they had assurance that we'd do whatever we had to do, in order to make sure they got the prize.

Results

The financing had no impact on existing lines of credit, loan, or other financing. The project created no negative cash flow in its early stages, yet the consulting team was being paid. The balance outstanding

on the line of credit did grow, but once cash flow from the improvements was positive, payments began. The payments all came from the positive cash flow being generated by the project. Financing could raise and lower payments, accelerate or slow repayment as they saw fit. In the meantime, the project progressed at an aggressive pace without the need for delays due to project budget approvals and finance searching for ways to pay for it all.

By the end of the project, we did indeed achieve the benefits we had forecast and then some. The client's finance department had been tracking the gains in production output and we used cost savings estimates attributable to areas in which we had worked to include costs savings. Ultimately we don't control what the client does, so forecast savings require them to take action which they may defer to slow down. They agreed however, that since those savings were a small portion of the overall gain, it would be reasonable to work from estimates of savings. That also had the advantage of providing their finance department with leverage to insist on budget reductions in future years.

To learn more

We know that maintenance and reliability improvements take some time and have an upfront sting. We also know that they can pay back that upfront cost, many times over and often with a good portion of it coming relatively early in the project.

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