PN-ACD-766

99582

Romania ESCo Development Task: Capital/Financing Plan

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Prepared for

United States Agency for International Development
Bucharest, Romania and Washington, DC
Contract No DHR-0030-C-00-5064-00

November 24, 1997

Romanian ESCo Development Program

Capital/Financing Plan

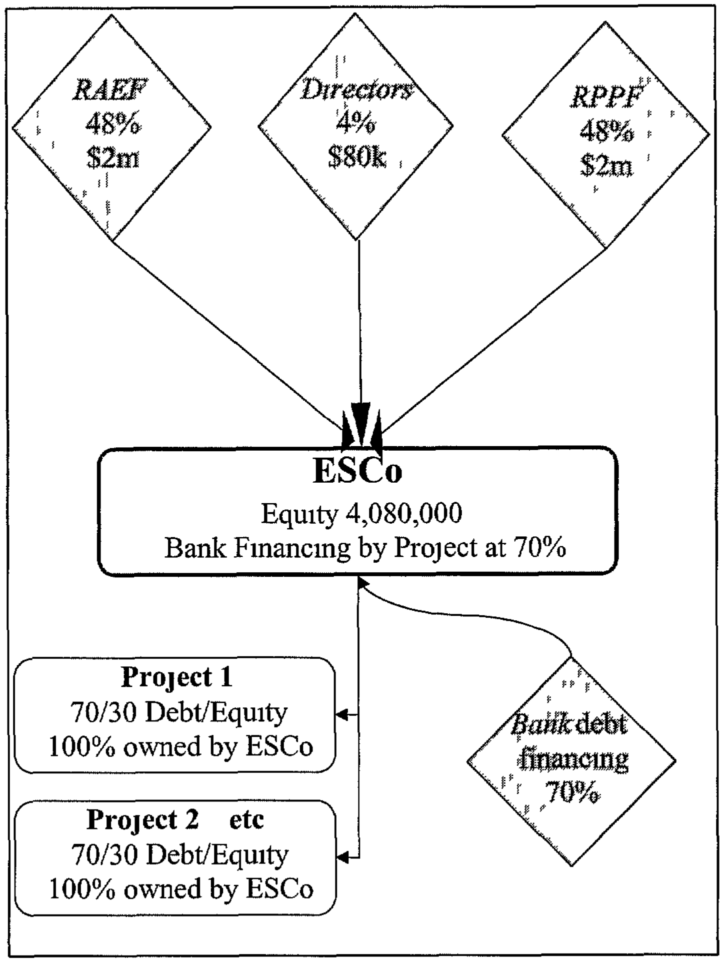
Introduction

The Electrotek Project Team has been assisting Energy-Serv in formulating a capital structure and financing plan for the new ESCo. While the proposed investors – the Romanian American Enterprise Fund (RAEF) and the Romanian Post Privatization Fund (RPPF) – have not yet reached acceptable terms with Energy-Serv over management's stake in the company, the basic capital plan has been accepted. There is considerable overlap between the previous deliverable on Corporate Structure and this deliverable dealing with the Capital Plan, but the two deliverables have some important differences in their focus. Whereas the previous deliverable answered the questions 'who will own what portion of the ESCo?' and 'what kind of ESCo corporation will be formed?' (e.g. self-financing ESCo, arranged financing ESCo, etc.), the capital/financing plan answers the question 'how much capital will be issued and when will it be needed?' The following discussion is meant to augment the proposed capital/financing proposals found in the business plan.

Capital Requirements

Establishing a proper capital structure for a start-up ESCo (or for most start-up companies) is as much about <u>when</u> the capital is issued as <u>how much</u> capital is issued. Investors do not want to invest all of their committed capital on the first day of incorporation if the ESCo will not need the vast majority of that capital until the end of the first year or in the middle of the second year. This is because any investor would rather earn interest on his under-utilized capital during the intervening months. On the other hand, company managers are rightfully leery of having capital shortages during their first operating year if capital is released in tranches according to a pre-agreed share issue schedule. However, management is concerned about having too much capital because it reduces the company's returns on equity, one of the primary performance measures that may determine management's bonuses. Finding the right share issue schedule is, therefore, a delicate negotiation.

As discussed in the Corporate Structure deliverable, the ESCo will be capitalized at US$4,080,000 of equity, with capital being provided by RPPF, RAEF and Energy-Serv's management at roughly 48%, 48% and 4% respectively. Additional debt financing will be secured to cover 70% of project costs. Equity capital is therefore intended to cover 30% of project costs, plus start-up costs and initial operating costs prior to cash flow being realized on the first projects.



Use of Initial Equity
The financial projections – developed with assistance from the Electrotek project team and included in the business plan deliverable – forecast that positive operational cash flow will be realized in the second full year of operation (1999) at roughly US$ 1 million Energy-Serv forecasts that overhead costs (office cars, marketing, communication, travel, and salaries) will be $49,445 per month, or $593,340 for the first whole year of operation In addition, Energy-Serv is expected to incur approximately $268,000 of start-up costs covering areas such as equipment, office furniture, recruitment, and training Additionally, Energy-Serv will need to use cash to cover its 30% equity contribution to project costs, amounting to roughly $1 6 million per year In other words, Energy-Serv will need paid-in, cash equity of roughly $2 5 million for the first year of operation (including Q4 1997) plus an additional $80,000 of fees to the two investment funds (covered by management's contribution)

Energy-Serv is projected to earn $1 million in revenues during 1998, but it is not until 1999 that the company will earn significant revenues ($6 million) As a result, the bulk of equity will need to be paid in during 1998 (and perhaps the end of 1997, if negotiations go well) The summary cash flow below demonstrates that $3,000,000 of paid-in equity during the first year (plus Q4 1997) will be sufficient to meet the company's cash needs while still leaving the company just over half a million dollars in cash reserves This reserve margin is important both for liquidity and in the event that cash flow from operations is delayed beyond what is projected in the forecasts An additional $1 million of equity would not be paid in until 1999, probably during the first quarter

Summary Cash Flow Statement

Years	1997, Q4	1998	1999
Cash Flows from Operations	- --	---	
Net Cash from Operations	**(148)**	**(132)**	**1,070**
Cash Flows from Investing Activities			
Sale (Purchase) Pl & Equip	(268)	(5 457)	(5 333)
Net Cash from Investments	(268)	(5 457)	(5 333)
Cash Flows from Financing Activities			
Borrowed LT Debt	0	3 820	3 733
Repayment of Debt	0	0	(626)
Sold (Purchased) Common Stk	1 000	2 000	1 000
Dividends	0	0	0
Net Cash from Financing	**1,000**	**5,820**	**4,107**
NET INCREASE (DECREASE) CASH	**584**	**231**	**(155)**
Cash at Beginning of Year		584	815
CASH BALANCE AT END OF YEAR	**584**	**815**	**660**

Both potential investors in Energy-Serv have indicated that they would expect their investments to be made equally on a pro-rata basis (i e , the first $750,000 tranche would come 50% from RPPF and 50% from RAEF) Management's contribution of $80,000 would be paid in as an up-front financing fee (therefore it does not appear in the summary cash flow statement) prior to either fund making their investments The proposed share issue schedule will therefore be as follows

Proposed Share Issue Schedule
US$ '000

Month #	*0*	*4*	*8*	*12*	*15*	***Total***
RPPF	375	375	375	375	500	2000
RAEF	375	375	375	375	500	2000
Energy-Serv	80					80
Total	830	750	750	750	1000	4080