



Investing in Nature – A Webinar Series

In partnership between the European Investment Bank, EU Business Biodiversity Platform and SYSTEMIQ



Business @
Biodiversity

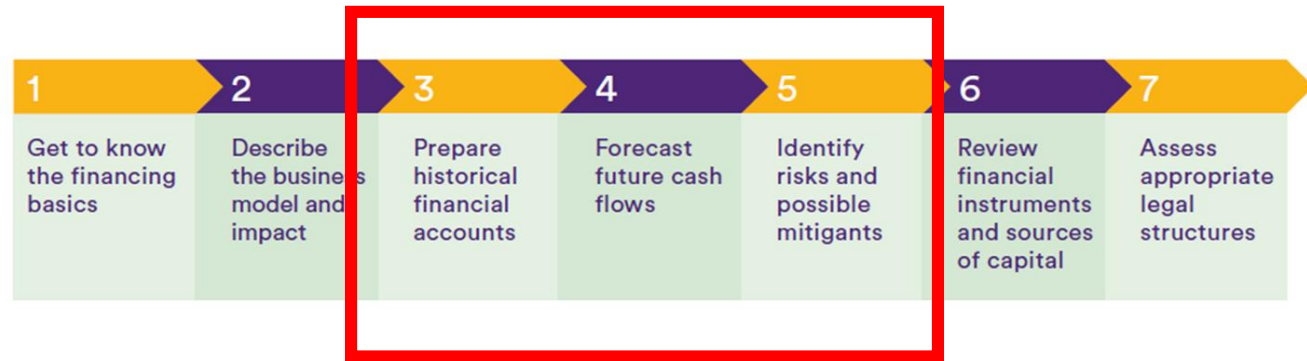
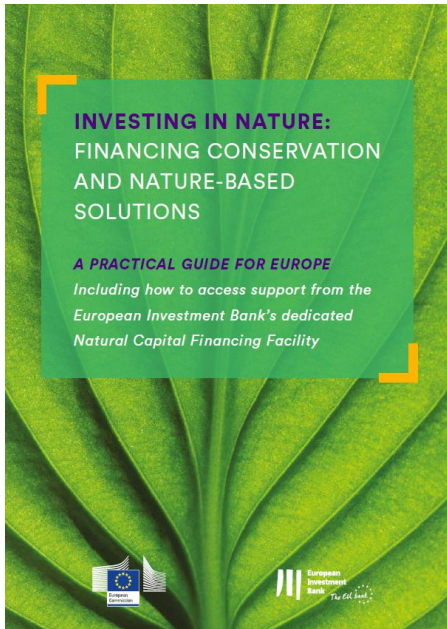




Webinar Series - Overview & Outlook

- ▶ PART 1: An introduction to financing investments in natural capital
- ▶ PART 2: Business models for conservation and nature-based solutions projects
- ▶ PART 3: How to prepare financials and strengthen commercial viability of your project?
- ▶ PART 4: Understanding different types of financing
- ▶ PART 5: Variety of legal structures and their pros and cons

Investing in Nature: A Practical Guide



<https://www.eib.org/attachments/pj/ncff-invest-nature-report-en.pdf>



Agenda


1. General principles of financial analysis and cash flow forecasting

- ▶ **Patricio Novales**, *Financial Monitoring Officer, Public Sector EU, Transaction Management and Restructuring (EIB)*

2. Specificities of investment in conservation and NBS projects

- ▶ **Vasco Ferreira Costa**, *Investment Officer, Natural Capital Finance Facility (EIB)*

3. Q&A



1. General principles of financial analysis and cash flow forecasting

1.1 Credit analysis: what it is and purpose?

What is credit analysis

- Forecast availability of cash flows vs. debt service obligations

Purpose

- Determine future debt service coverage and likelihood/probability of default. This is expressed through a rating, which ranks counterparts on a scale according to their creditworthiness

Rating assessment

- Vary for each asset class, incorporating both quantitative and qualitative elements



1.2 Credit analysis: different categories

Corporates

- Standalone credit assessment (i.e. no reliance on external support)
- Hinges on stability and predictability of own cash flows
- Important qualitative elements:
 - Business risk (specific to the single corporate)
 - Industry risk (general to the sector in which they operate)

Local and Regional Governments (LRGs), i.e. municipality, region

- Standalone credit assessment, but higher stability thanks to the institutional framework (rules governing public bodies in each country, which is qualitative)
- Metrics: operating and budgetary surplus/deficit

Public Sector Entities (PSEs), i.e. public agency or company

- Credit-linked, top-down approach, based on the likelihood of support from the parent
- Legal basis and incentive for support (qualitative assessment)

Two common metrics

1. Leverage: $\text{debt} / \text{operating balance (EBITDA for corporates)}$
2. Coverage:
 - Interest coverage: $\text{operating balance (EBIT or Funds from operations for corporates)} / \text{interest charges}$
 - Debt coverage: $\text{operating balance (EBITDA or Free cash flows for corporates)} / \text{total debt service (principal + interest)}$

1.3 Relevant documentation to be presented for loan approval

Financial Statements (Audited)

- Corporates: Balance sheet / Income statement / Cash flows statement
- LRGs: Operating and capital revenue and expenditure/ Statement of debt/ Fund flow statement
- PSEs: Normally corporate-like or hybrid

Legal Documentation

- Corporates: By-laws, covenants, shareholder agreements, etc...
- LRGs: Laws and regulation on financing system, responsibilities, etc..
- PSEs: By-laws, regulations, comfort letters, guarantees, etc...

Additional Information:

- Industry and business trends

Be prepared for “Know Your Counterparty”:

- Background information on key persons, shareholding structure, tax compliance, etc

1.4 What inputs are needed

Backward information:

- 3-5 years financial statements
- Understanding of:
 - Corporates: Business model and industry risk, investment plans
 - LRGs: Institutional framework and interaction with upper and lower government tiers
 - PSEs: Decision-making and control, cases of government intervention or extraordinary support
- Sensitivity towards economic variables: GDP, interest rates, unemployment...

Forward Looking Analysis:

- 3-5 years projections
- Assumptions on economic variables and execution of investment plans
- Key aspects: debt coverage, availability of cash flows and leverage
- Scenario analysis: base case vs. stressed case

Project Analysis

- ≠ From counterparty/borrower analysis
- “Capital budgeting”: revenues, expenditure, funding and debt servicing over projects life.
- “Net present value”, “internal rate of return”
- Externalities: Economic rate of return



2. Specificities of investment in conservation and NBS projects



2.1 Typical challenges: cash flow forecasting

- ▶ Reliance on promoter's financial sustainability and less on stand alone project cash flows
- ▶ Small size of project promoters; limited diversification of revenues sources or financial history
- ▶ Difficulty to create a stable revenue stream and anticipate long term project risks
- ▶ Long investment and repayment profile (e.g. forest, flood prevention, ecosystems restoration), need for 'patient capital'
- ▶ Lack of collateral/guarantees/de-risking instruments



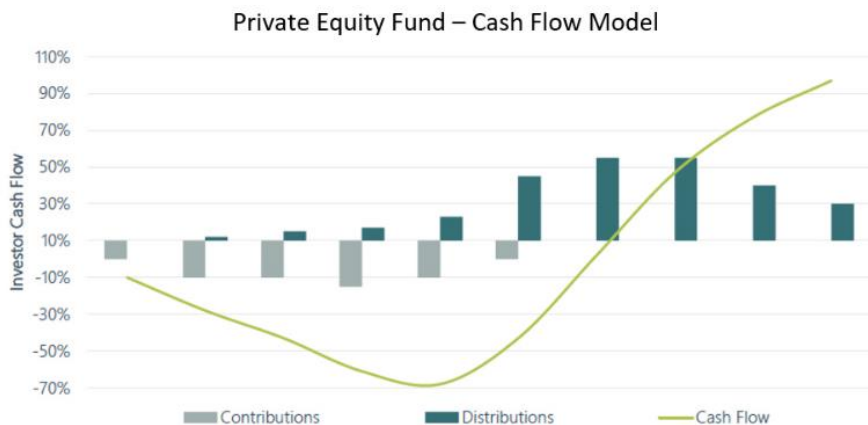
2.2 Typical challenges: additional elements

In addition to the traditional business planning, promoters of conservation and NBS projects shall highlight in the funding applications:

- ▶ Regulatory framework and market incentives
- ▶ Ownership, partnerships and potential for ongoing support
- ▶ Key people, core team track record, complementarity, staff planning and corporate governance
- ▶ Sound explanation on main business assumptions supporting the cash flow forecast
- ▶ Well-structured SWOT analysis, identify key challenges, risks and mitigants
- ▶ Impact monitoring indicators, measurement and report

2.3 Cash flow model for equity funds

Funds



- EIB/NCFF supports private equity funds investing into conservation and NBS projects.
- Private equity has traditionally lock-up periods of 8-12 years but potentially even much longer (e.g. forest funds)
- The cash flow forecast of private equity funds shows typically ‘J-Curve’

Investment Stage	Development stage	Maturity/Liquidation stage
Year 1 through year 4-5, typically	Year 3 to year 8, typically	Year 8+, typically
<ul style="list-style-type: none"> » Capital is committed and drawn down » Investments are made in portfolio companies 	<ul style="list-style-type: none"> » Initial investment starts to mature » Mature investments are exited » Cash distributions are paid to investors » Follow-on investments are made 	<ul style="list-style-type: none"> » Most investments have been exited » Several investments are left to “wind down”

Schematic illustration. Source: RCP Advisors and Marquette Associates. As of 3/8/18.

2.4 Examples of cash flow analysis for conservation /NBS projects

PROJECT EXAMPLE	TYPICAL CASH FLOW PATTERNS OVER TIME	CORE FINANCING NEED	EXAMPLE FUNDING	DESIRED OUTCOMES
SUSTAINABLE FORESTRY		<ul style="list-style-type: none"> Initial capital investment and ongoing operations (e.g. land acquisition, equipment, planting and maintenance of trees) 	<ul style="list-style-type: none"> Equity fund (see the example of the SLM fund, backed by NCCF funding) 	<ul style="list-style-type: none"> Revenues from timber sales (for a newly planted facility, this will be a long cash cycle) Potential additional revenues (e.g. from sale of verified carbon units (VCUs) or Payment for Ecosystem Services)
SUSTAINABLE AGRICULTURE		<ul style="list-style-type: none"> Capital investment to adjust traditional practices (e.g. additional equipment) 	<ul style="list-style-type: none"> Indirect debt (for example, loan through a local bank) 	<ul style="list-style-type: none"> Premium prices for environmentally-supportive practices, and/or potential increased yields drive increased revenue Cost savings from reduced use of artificial inputs (fuel, fertilisers, pesticides)
SUSTAINABLE AQUACULTURE		<ul style="list-style-type: none"> Initial capital investment to establish new farm (infrastructure, equipment, purchase of stock etc.) 	<ul style="list-style-type: none"> Equity fund (with a mandate to invest in marine conservation) 	<ul style="list-style-type: none"> Revenues from sales of aquacultural products, increasing over time Enterprise becomes profit-making, allowing for potential 'exit' through sale of the enterprise, or shares, to new investor
ECOTOURISM*		<ul style="list-style-type: none"> Initial capital investment for creation of new lodge (infrastructure, equipment, land leases etc.) 	<ul style="list-style-type: none"> Indirect debt (loan from local financial institution e.g. HBOR, Croatia) 	<ul style="list-style-type: none"> Revenues from paying tourists increasing over time Revenues exceed operational costs (staff salaries, supplies etc.); debt repaid from profits
CARBON SEQUESTRATION PAYMENTS		<ul style="list-style-type: none"> Initial capital investment to establish new enterprise and start operations (acquire project land, baseline surveys etc.) 	<ul style="list-style-type: none"> Equity fund (e.g. with a mandate to invest in Payments for Ecosystem Services projects) 	<ul style="list-style-type: none"> Revenues from sale of Verified Carbon Units (VCUs) to voluntary corporate buyers or sale of biodiversity offset payments exceeding operational costs
GREEN INFRASTRUCTURE*		<ul style="list-style-type: none"> Initial capital outlay for purchase and installation of infrastructure 	<ul style="list-style-type: none"> Direct debt on concessional terms (to cover portion of infrastructural investment) 	<ul style="list-style-type: none"> Cost savings from reduced operational costs increase over time to optimum

* Further information for these examples, including alternative funding options, are explored within the Case Studies in Part D.



2.5 Understanding risk mitigants and their relevance

RISK MITIGANT TOOLS	DESCRIPTION	TYPICAL BARRIERS OR RISKS IT CAN ADDRESS
ADDITIONAL EQUITY	Raising more capital from new and/or existing shareholders	Lack of equity overall or high financial leverage (e.g. relatively high debt compared to balance sheet size, potential risk that cash flows will not be sufficient to service debt)
GUARANTEES	Third-party that can step in to cover financial obligations in adverse scenarios	Can help to improve access to financing (and potentially reduce pricing / interest margin), overcome lack of credit history , novelty of concept or other risks (including lack of financial experience)
COLLATERAL	Pledging security for the payment of loans (e.g. property or land)	Same as above (guarantees). However, land tenure challenges can be a common reason that prevents land being used as collateral
OFF-TAKE AGREEMENTS OR SALES CONTRACTS	Entering into contractual arrangements with future buyers of products	Can help to improve credit profile and reduce demand risk (increase visibility and predictability of sales and cash flows)
TECHNICAL ASSISTANCE	Support programmes for capacity building and pipeline development (typically grants)	Support from external professionals (including mentoring, board advisors, consultants) or strengthening internal skills and capability to overcome lack of financial or project development experience
FIRST-LOSS OR SUBORDINATE CAPITAL	Subordinate capital layer in a fund acting as "buffer" for a portfolio	Having layers in a fund structure (with differentiated risk and return expectations instead of on equal terms) can help to increase access to risk-adverse investors
INSURANCE AND HEDGING	Standard or bespoke finance solutions to protect against specific risks or fluctuations in commodity prices	Can act to improve access to financing and potentially improve pricing / interest margin as certain risks are transferred to other parties. Adds complexity and costs. Standard "business as usual" insurance tends to be a requirement by lenders
RESULTS-BASED INCENTIVES	Contractual arrangement offering financial reward based on achievement of performance criteria	Additional (conditional) revenue stream by identifying partners willing to pay for impact or performance, which can strengthen credit profile and improve predictability of cash flows . Incentive mechanism which acts to compensate for the opportunity cost of alternative revenue options



Q&A



Annex:

For further information, including submitting any projects proposals, please email the NCFF team at NCF_Instrument@eib.org.



NCFF – Natural Capital Financing Facility

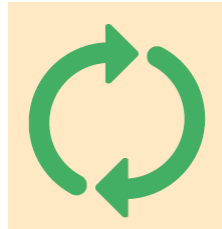
A financial instrument blending EIB finance with funding from the EC's LIFE programme (the EU's funding programme for the environment and climate action)

- **Debt, equity & grant-based technical assistance component**
- Overall size: EUR 100-125 million
- Pilot phase: 2015 – 2021
- Target: 9 -12 or more operations

Support objectives of LIFE regulation/programme by financing projects in EU that:

1. Are likely to have a **positive impact on biodiversity** and/or
2. Apply nature-based solutions for **adaptation to climate change**

NCFF Project categories



- **Payments for Ecosystem Services (PES):** projects involving payment or compensation for the benefits provided by ecosystems, such as cleaner water, higher soil quality or enhanced carbon sequestration



- **Green Infrastructure (GI) projects:** investments in natural capital that generate a range of goods and services, such as water quality, flood protection and climate change adaptation



- **Biodiversity offsets:** projects developing offsets through conservation measures designed to compensate for the unavoidable damage to biodiversity arising from development projects



- **Pro-biodiversity and adaptation businesses:** projects involving the supply of goods and services from conservation activities, such as sustainable forestry, agriculture, aquaculture and ecotourism

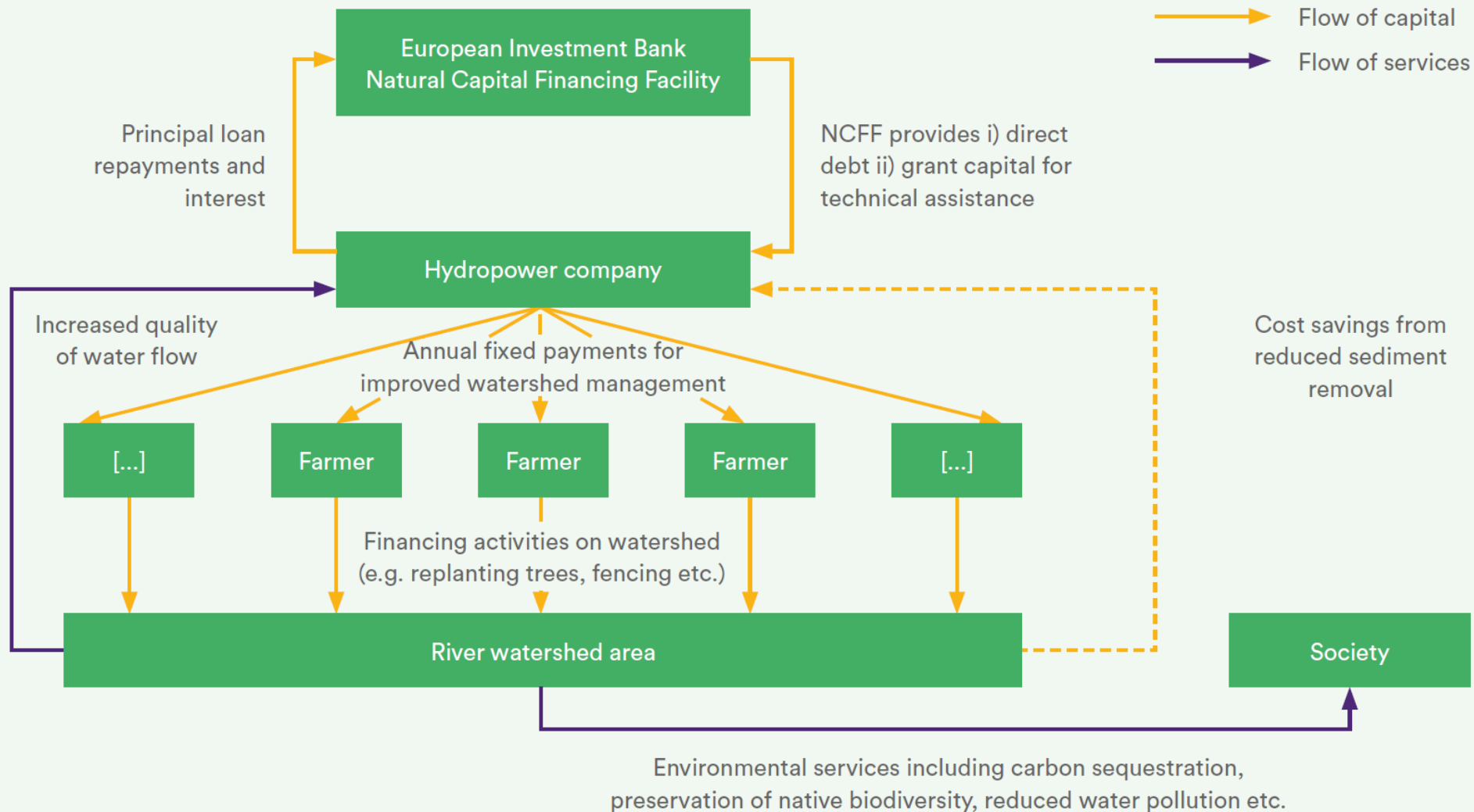
Eligibility criteria

- ▶ Projects must be exclusively located in the EU, generate revenues or save costs to repay investment.
- ▶ **Typical size of operation: EUR 5-15m**
 - ▶ Loan (direct or intermediated)
 - ▶ Fund (participation)
- ▶ Operations either stand-alone/dedicated interventions or as integrated part of broader infrastructure/environmental programmes
- ▶ Tenor normally 15 years, can be longer, subject to economic life
- ▶ **Up to 75% of project costs** (as opposed to normal EIB limit of 50%)
- ▶ Private (commercial, NGO) or public entities (cities, municipal companies, etc.)
- ▶ **Technical Assistance: envelope of EUR 10 million, up to EUR 1 million per project**



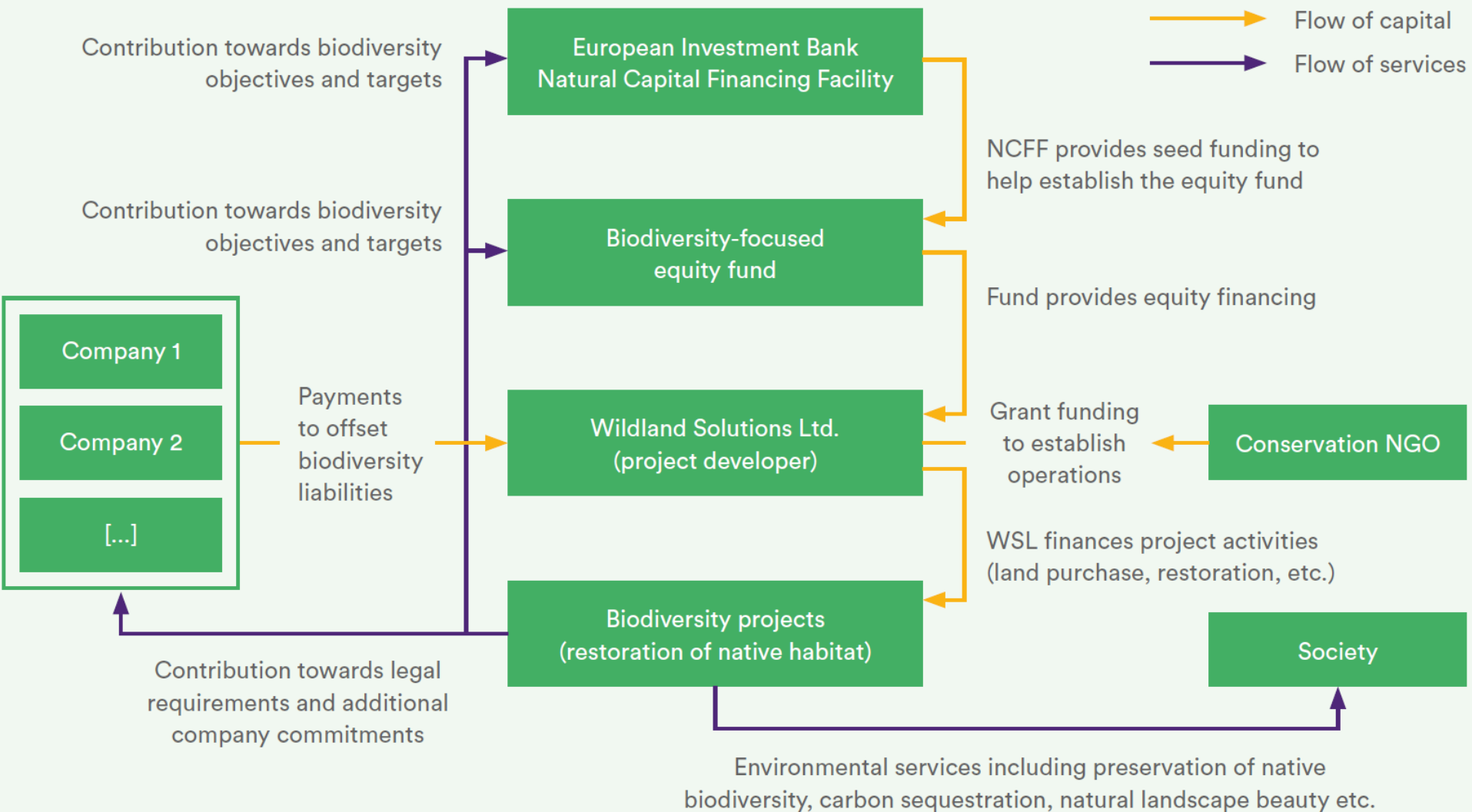
Case Study 1: Payment for Ecosystem Services

Exhibit 1: Capital and service flows in a Payments for Ecosystem Services watershed agreement.



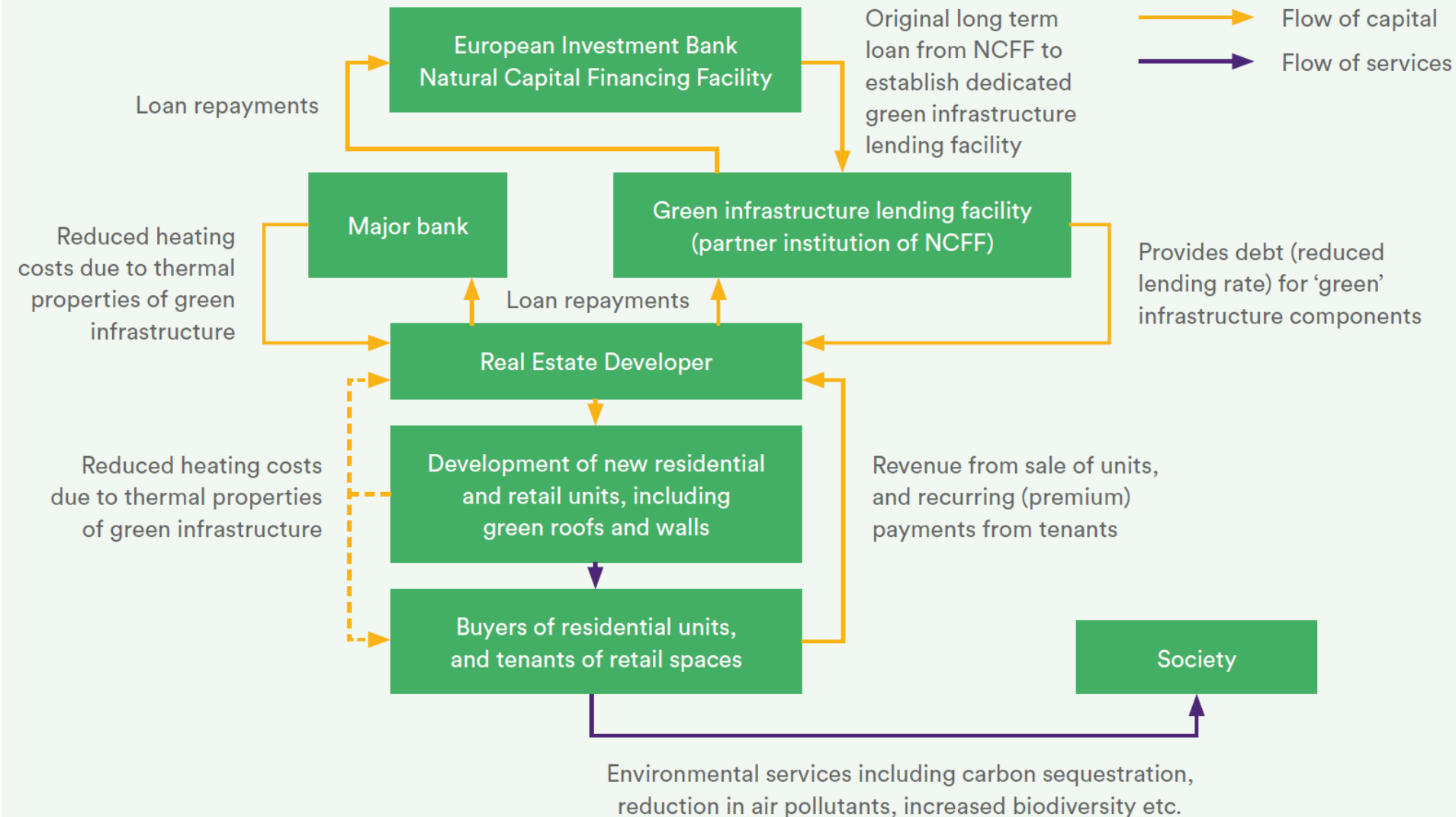
Case Study 2: Biodiversity Offsetting

Exhibit 1: Capital and service flows in a biodiversity offsetting agreement.



Case Study 3: Green infrastructure

Exhibit 3: Capital and service flows in urban developments with green infrastructure components agreement.



Case Study 4: Pro-biodiversity & adaptation business

Exhibit 4: Capital and service flows in the establishment of a new ecotourism enterprise

