

FINANCING AN ALCOHOL VENTURE

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FINANCING

We can help you define financing arrangements for an alcohol venture. We will work with you to identify the best financial structure of the venture, to locate appropriate sources of money (both equity and debt), and --if needed-- to make arrangements for buying feedstocks and selling by-products.

Selecting the best financial package for the venture is important because the financing influences the profitability and the overall economic viability of the venture. It affects such important costs as interest, it limits the amount of available tax credits and subsidies, and it affects eligibility for loans and grants. Details of the financing packaging can also be critical in protecting your control of the venture and your return on your own portion of the total investment. The total of the financial arrangements specify, in effect, how you

- can assemble the total capital so as to minimize the costs of money
- can best leverage your money and obtain a good return on your investment
- can maximize cash flow and income
- will meet important financial risks and contingencies, especially market price fluctuations and technical risks of production
- best secure a supply of feedstocks
- will manage the venture

Thus, the financial packaging is a big part of the project feasibility study and venture planning.

Determining Relative Amounts of Equity and Debt

Alcohol ventures differ, and it is not worthwhile to invent many general rules about how ventures should be financed. However, it is most common that ventures strive for maximum equity and minimum debt. This improves profitability by minimizing interest charges. In addition, many alcohol ventures show a varying profitability as feedstock and by-product prices vary. Carrying too much debt in such a business implies risks of not being able to pay creditors for brief periods.

Higher levels of debt can be carried if:

- the feedstock situation is under your control or is otherwise secured (such as perhaps by forward contracting or by hedging) or has relatively low costs
- the product and by-product markets are secure, especially if you consume most or all of your alcohol and by-products, or can protect yourself with long term contracts
- you qualify for a loan guarantee or for government loans or bonds or co-operative agreements

- technical risks are low: feedstocks are known and understood, the process has been used before
- you have other income with which you can guard against brief liquidity problems in the alcohol venture

ALH will work with you and your financial and tax advisors to arrive at the best balance of equity and debt for your particular situation. We will also examine the various middleground options, particularly debt instruments convertible at later dates to stock, and preferred stock convertible to common stock.

Finding Sources of Equity Funding

If you want help in locating sources of equity capital, we will help you explore the alternatives and find the best approach for you. We can assist you in determining what resources you can contribute to the venture and what equity share you should receive for them. We can help you find partners or form a cooperative. We can define possible joint ownership with the important customers, especially those for your alcohol and by-products, or your suppliers of feedstock, or even your suppliers of equipment for the plant. We will examine common sources of investment money such as venture capital organizations, equity funding firms, cooperatives, insurance companies and pension/retirement funds, and foundations and trusts. We will also study the opportunities evolving in alcohol franchising operations which can provide some of the capital you may need. We can structure private and public stock offerings. And lastly, we have special experience in proposing and winning government support available in the form of grants, cooperative agreements, and contracts from a wide range of local, state, and federal agencies.

Creating a No-Ownership Option

Sometimes you may find it greatly to your advantage to create a "no-ownership" option, in which you have no equity share in the venture. Ownership of your plant by a city or other government authority may make you eligible for greater government financial support and for lower taxes, and still let you operate the plant for a fee or a share of the proceeds. Similarly, you may want to structure a project so that it is entirely owned by the alcohol customer or by the equipment supplier, but you still operate the plant, manage the feedstock and by-product operations, and make a profit. We can help you define the options and approach the prospective owners.

Finding Sources of Debt Funding

If you want, we can help you choose an investment banker. We will work with your banker to help him understand the technical and market risks involved and to define the best form of debt for your case, especially the form of security. This may include specific equipment, your general property, other collateral, or your general credit. It might also include the specific credit of the alcohol venture itself; this we describe under "project financing" below.

We will help prepare a prospectus (as described in our information sheet on "Feasibility Studies") and locate the most appropriate sources of debt money. The list of candidates includes:

- banks
- savings and loan institutions
- mortgage companies
- credit unions
- finance corporations
- venture capital corporations
- foundations and trusts
- insurance companies and pension/retirement funds
- cooperatives
- franchising organizations
- public placements
- customers
- feedstock suppliers
- equipment suppliers

There is also a long list of government possibilities, many of which are still evolving as the President's Synfuels Program becomes implemented in the early 1980's. Current federal programs include:

- U.S. Department of Agriculture, Farmers Home Administration, Business and Industry Loan Program
- U.S. Department of Commerce
 - Economic Development Administration
 - Small Business Administration
 - Minority Business Development Agency
- U.S. Department of Housing and Urban Development
- U.S. Community Services Administration
 - various energy and community development programs
- U.S. Department of Energy
 - Office of Resource Applications

There are also many state programs and some local programs. Industrial development bonds backed by municipalities or other authorities are often very attractive for alcohol plants, especially if the interest is (as is usually the case) not federally taxed as income to the bondholder. Use of such funding may limit tax credits, however.

The amount of assistance available, repayment terms, restrictions and limitations (especially in the case of cost overruns during engineering and construction), and applications procedures vary greatly. Often, direct loans are available. Sometimes cooperative agreements are available, for which repayment terms may be proposed by the applicant. In favorable situations, these agreements resemble interest-free loans. Most agencies offer loan guarantees which greatly simplify obtaining loan money from private sources.

Foreign governments can also be an important source of low-interest (or even no-interest) loans if your plant includes foreign equipment. This can be an important help in the financing.

We would be happy to provide up-to-date assistance in finding and obtaining the loan support best for your venture.

Arranging Project Financing

The term "project financing" covers a variety of meanings. To some, the term refers to the structuring of the total borrowing so that parties in addition to the alcohol venture itself stand behind the loan to the alcohol venture. The retirement of the debt is anticipated by the lender to occur only from the revenue of the project and is not otherwise backed by the owner. This can often be arranged if the purchaser of the alcohol enters into a long term "take or pay" contract in which the alcohol venture is, in effect, guaranteed income even if production is interrupted. Sometimes it is necessary to have a feedstock supplier committed to a "deliver or pay" supply contract.

"Project financing" sometimes refers to a special joint venture formed in such a way that the borrowings do not show as a liability on the owner's balance sheet. Such off balance sheet ventures can be structured under certain circumstances if the owner has equity partners.

Creating a Not-For-Profit Venture

You may be able to meet your objectives with a non-profit venture. These ventures qualify for substantial tax advantages and borrowing opportunities over and above those available to profit-making ventures, and can still pay you a fee for operation. We can help you explore the benefits of this approach.

Acquiring Feedstock

If you are not supplying feedstock for the alcohol plant, you may need special approaches to guarantee supply or price. You may need forward contracts for supply. Terms and conditions of such contracts must be thought through carefully, especially if the contract is key to financing. If you need to commit to deliver alcohol at a contract price, but do not own feedstock to cover this commitment, you may need to lock in your feedstock price by taking a position in the futures markets (hedging). We have many years of experience in commodities contracting and can help you approach this resource management problem. If you wish, we will locate suppliers or sellers and negotiate purchases.

If you do produce some or all of your feedstock, you will want to take advantage of the evolving USDA price support programs for crops intended for alcohol production. Again, if you need help here, we are ready to assist.

Marketing Products

If you do not consume all your alcohol product and by-products, you may need help with marketing and selling. Even selling alcohol has many complexities when all aspects of distribution and end use are considered. Industrial users, who might use alcohol as fuel in engines, gas turbines, and boilers, and use lower proof alcohols that are easier and cheaper to produce, as can some operators of fleets of vehicles, and usually have sufficient storage to tolerate occasional interruptions in supply. Selling alcohol to these users therefore differs from selling alcohol for use in gasohol, where proof requirements are high and the purchaser usually requires reliable delivery schedules.

Protein by-products have unique marketing and selling requirements, with extensive use of forward contracting and sometimes drastic financial penalties for undesired variations in by-product properties.

Vegetable oils and carbon dioxide usually have simpler marketing requirements, but the dollar flow represented by these by-products can have decisive effects on plant profitability. Hence a proper sales contracting approach is essential. We can provide you with as much help as you require in forming your approach to each market, and in making the necessary financial and contract arrangements.

Subsidies and Tax Credits

Subsidies and tax credits must be clearly understood and defined, as they greatly influence the safety and economic viability of the venture and hence its attractiveness to investors and lenders. It is important to know that the amount of subsidies and credits available to you depends on which financing option you choose. Our information sheet on "Feasibility Studies" discusses the many Federal, state, and local government subsidy and credit programs.

Handling International Projects

An alcohol project linking the U.S. to other nations, or only involving other nations, may qualify for many additional forms of loans, loan guarantees, grants, subsidies, and tax advantages. U.S. agencies in the Department of Agriculture, for example, are especially helpful in promoting exports. Banks specializing in export/import ventures are good sources of loans. The Department of Energy has special budgets for international projects. And, of course, the Agency for International Development has major programs. Projects involving foreign equipment often qualify for very inexpensive long term loans from producing countries with aggressive export or industrial development programs. We can help you determine if you qualify for any of these special opportunities and can work out the necessary arrangements.

Conclusions

Determining the best financial structure of an alcohol venture involves no profound mysteries. The best structure is a very logical outfall of the contributions and goals of the participants, combined with a realistic assessment of the risks--technical and market--and possible rewards of the venture. The real task is to see all these aspects clearly and truly. The best and fairest form of the venture generally follows with relative ease.

There then remains, to be sure, a mass of detail that must be worked through:

- locating sources of equity and debt money
- identifying conditions and limitations on the use and repayment of the money
- applying for the money by explaining the venture, its risks and rewards, completing applications, prospectuses, business plans, feasibility studies, and proposals
- contracting for obtaining feedstocks and selling products

ALH can help you at every step of the financing process. We prefer to work with your banker and counselors in defining and assessing technical and market factors because they--and you--know your situation and your business best. If you want more assistance from us, we can ourselves structure the package, locate equity and debt money, and obtain it, and we can arrange contracts for feedstock supply and product sales. We are very proud of our wide-ranging experience in all areas of venture formation.