Case Study

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Minerva Ltd: Risk mitigation using project financing

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Abstract

This case is intended to demonstrate to the participants how to mitigate various sources of risk using project financing. Participants would start with defining risk and listing various sources of risk the project is exposed to. Then, it explains how to prioritize various sources of risk based on the severity. Once the sources of risk are identified and severity is determined, then explain the principles of risk mitigation and how these principles would determine the structure of the project. Overall, this case shows how project financing could be used to manage various sources of risk and what is the role of project structuring in risk mitigation.

The company

Minerva Ltd is a listed firm belonging to the Durga business group, a very prominent business group run by the Gonchikar family. With a 3 million tonne annual capacity, it is the third-largest iron and steel plant in the country. Armed with captive coal and iron ore mines, it has a very healthy gross profit margin of about 25%. With the asset size of Rs. 56721 cr, they are able to clock about Rs. 23456 cr revenue in 2022. These assets are financed using debt to the extent of 40% which is much less than its close competitors. They have achieved this growth mostly through organic investments in the existing plant, which is located near the Chitradurga district of Karnataka. Due to favorable policies from the government of India, they have become a very strong player in the industry. The group is not ambitions over its growth plans but wants to operate in safe and stable environments. They do have a presence in over 30 countries as exporters. About 35% of their revenue is derived from these exports. However, recently, cheap Iron from Chinese firms has given them tough competition in the domestic and international markets. Slowly, they are losing their ground in the international market as they are not able to compete with Chinese manufacturers as most of them have their plants set in foreign countries, which not only make their product cheap but also get favourable treatment from foreign countries.

The project

To address this issue, the board of directors of Minerva Ltd. has asked the CEO, Ms. Anusuya, to explore the possibility of setting up an Iron and steel plant in a foreign country, preferably in Africa. A new opportunity has come up for the company in South Africa. The government

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of South Africa has invited tenders to develop a 2 MLT iron and steel plant in the northwest part of the country. Setting up a plant in this part of the world would help Minerva Ltd to have a competitive advantage over other players in the region and capture the fast-growing African market. Ms. Anusuya sees a good opportunity with this project. However, there are many major challenges she has to address. For example, South Africa (SA) is an unstable society with a very volatile economic environment.

The Apartheid issue divided the communities, and the political system represented this fractured society. Also, there is a movement for nationalization of resources, especially from the resource-rich but impoverished areas of the country. Also, SA's relationship with its neighbors has a lot to be improved. The economic environment reflects this instability, with the GDP growth rate being very volatile in the last ten years (Exhibit 1). Though SA has free trade agreements with the neighboring countries, nothing much has been translated into real economic exchange. The current political regime has made economic development its top priority and thus has invited foreign investment in various sectors, including Iron and steel. She also feels strongly that any delay in the construction of the plant may cost the company very much, and this is a real probability as foreign firms are only allowed to use SA firms for construction. Ms. Anusuya feels that three good construction firms can help them in building the plant in time. She feels that the board may have differing views on her proposal, given these risk exposures. She has proposed that project financing be used to finance the project as it allows to address all the risks adequetly. Therefore, she has to structure the project, which adress the risks identified and thus convince the board members. Specifically, she has to answer the following questions

1. What are the possible risks that the project is exposed to?
2. How important these sources of risk are for the overall success of the project?
3. What risk mitigation strategies does she have to adopt to address each type of risk?
4. How to incorporate risk mitigation strategies in to the project structure.

Exhibit 1: GDP growth rate of SA

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
GDP growth	8%	3%	5%	7%	2%	8%	4%	5%	9%	3%

Exhibit 2: Projected Demand for Steel in SA and Africa

Year	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030
Demand in MLT	45	48	53	58	62	71	80	85	89	95

Exhibit 3:
SA's trade with different trading blocks

Trading block	Overall Trade
Africa	180
Asia	330
Europe	280
Australia and NZ	60
North America	246
South America	176

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