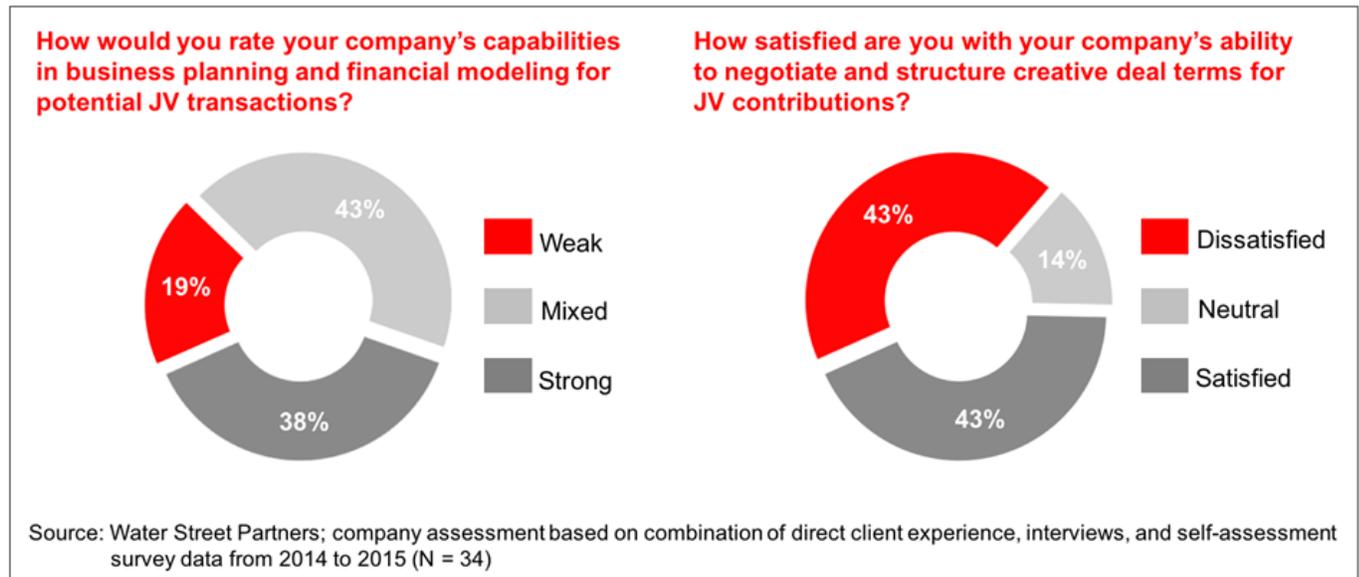


customers and systems. Once the model was expanded, it revealed that 85% of the total venture returns would be derived by the counterparty by Year 5, despite it only contributing 50% of the capital and assuming 50% of the risk.

To help companies address the unique challenges presented in JV dealmaking, including those related to financial modeling, we have developed a set of 20 best practices we call “JV Dealmaking Standards of Excellence.” Today’s post addresses challenges raised by financial modeling in joint venture deals, and illustrates one approach to modeling Total Venture Economics.

Exhibit 1: The Challenge of Financial Modeling in JV Dealmaking



What the standard says. Our standard provides that, to achieve excellence in joint venture dealmaking, a company must develop a financial model of the proposed JV that includes an integrated picture of Total Venture Economics for the company and the counterparty.

Components within the standard. To fully meet the standard, this integrated picture of venture financials developed by a company should include:

- The forecasted P&L of the JV entity
- Each shareholder’s startup investments and other initial costs not included in JV P&L
- Shareholder margins (or subsidies) associated with their provision of services to the JV
- Shareholder technology, brand, or other license fees to or from the JV
- Financial benefits (e.g., below-market pricing) from the supply and offtake agreements with the JV
- Other off-P&L financial benefits and costs (e.g., cross-selling benefits, increased customer penetration and retention) that accrue to a shareholder
- Cumulative cash-out position for each shareholder over time

In addition, the financial model should include sensitivities for all key assumptions (e.g., JV volumes, time to market, pricing, cost structure).

What it looks like in a company. To illustrate, consider a multi-billion dollar alternative energy venture between four partners, which was formed to develop and commercialize a radical new technology. We helped the deal team of one party identify the financial flows of each partner, estimate the costs and revenues associated with each of these flows, and evaluate how the integrated economics for each partner would play out over time (Exhibit 2). This allowed the deal team to forecast the cumulative free cash flow of each partner over 15 years – which showed that Partner 3 would likely fall into a severely negative cash flow position in Years 6 to 8. Because Partner 3 was the main technology supplier to the venture and did not have a strong balance sheet, this insight raised concerns about its willingness to remain in the venture over the long term – and the viability of the venture itself.

Understanding Total Venture Economics led our client to reset the proposed financial terms of the deal, including reducing future technology licensing and service fees paid to Partner 3, in exchange for co-funding of certain early-year technology development costs.

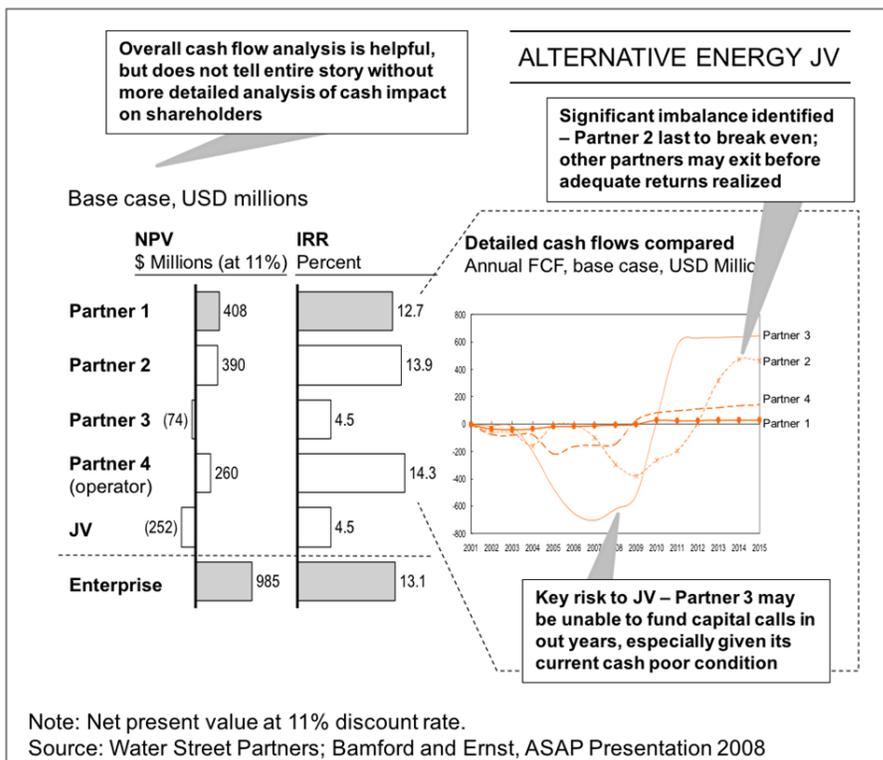
A distinguishing feature of joint ventures is that profits, revenues, and costs can flow in many different forms, and from many different directions – and this flexibility is both a blessing and a curse. It is a blessing because this flexibility allows value to be captured in unique and potentially more efficient ways, and a curse because it can obscure partner economics and drive misalignment. Creating a snapshot of Total Venture Economics can be an extremely helpful tool for avoiding the curse in favor of the blessing. With a clear view of various sources of venture value (and whether that value accrues to the JV or to one parent company), dealmakers can focus their attention on crafting and driving alignment on innovative deal terms to capture and protect value on an ongoing basis.



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Exhibit 2: Cumulative Cash Flow, by Partner



Water Street Partners LLC – About Us

Our Firm

Water Street Partners is the world's leading advisory firm on joint ventures. Our work focuses on negotiating and structuring venture transactions, managing the launch and integration process, and supporting owners, Boards, and management teams on improving and restructuring their joint ventures and other partnerships.

Based in Washington DC, Water Street Partners works on ventures across a range of industries, including energy and natural resources, technology, aerospace and defense, media, and consumer goods. Roughly 80% of our work is cross-border or involves partners from multiple countries.

Since 2008, Water Street Partners has directly supported more than 200 clients on ventures representing more than \$480 billion in value.

Our Services

Water Street Partners supports clients in three ways:

Consulting – Customized support for clients working on venture negotiations and structurings, integration, governance, and restructurings.

Joint Venture Deal Advisor – An annual membership service providing dealmakers with access to: (i) an online suite of tools, guides, and sample contracts related to venture transactions; (ii) a database and case library of creative venture deals; (iii) networking opportunities; and (iv) on-call advice and support.

Joint Venture Advisory Group – An annual membership service providing JV CEOs, JV Board members, corporate center executives, and others with access to: (i) an online suite of tools and guides related to governing and managing joint ventures; (ii) networking and education opportunities; and (iii) on-call advice and support.

Our Publications

Water Street Partners has three publications:

The Joint Venture Exchange (JVX) – A monthly publication aimed at JV CEOs, JV Board members, corporate center executives, and others with a direct role in managing and governing existing joint ventures.

The JV Deal Exchange (JVDX) – A publication targeted at dealmakers, aimed at providing provocative perspectives, practical tools, best practice approaches, and contractual terms that are directly usable in active deal negotiations.

Water Street Insights (WSI) – A weekly online publication for all business audiences that expresses our views on a wide range of business strategy and general management issues pertaining to joint ventures and alliances



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