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How to secure offtake for your first-of-its-kind project

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At a recent bioeconomy-focused ABLC conference I counted over a dozen companies striving to 'bring to life' first-of-its-kind (FOIK) projects, in renewable chemicals, fuels or materials – typically requiring hundreds of millions each in financing. A critical ingredient to make these real? High-quality – *investment-quality* – offtake agreements.

This article will dive into the must-haves for these agreements, as well as the art of getting first-mover strategic buyers to commit.

Solid offtake agreements provide the assurance investors need

Not LOIs. Not expressions of interest. You'll need binding agreements, with few exit ramps. More specifically, equity investors, debt providers or loan guarantors will be looking for:

1. *Long-term agreements*: Investors want to be sure that you can sell your product. Debt providers want to see offtake agreements that extend for the term of any loans, or a substantial portion thereof (and therefore show you can service the debt); they're especially sensitive about the risk of losing money. Equity investors want solid IRR. But while you're asking for eight, ten or fifteen year commitments, your buyers may only want to commit to one or two years.
2. *Guaranteed profitability*: Investors prefer to see that you're 'guaranteed' to make money, or at least have a high likelihood of being profitable. But tying your selling price to a market index may not guarantee or assure profits, especially if you're making your product in a new way (e.g., using renewable feedstocks rather than fossil). One way to resolve this is to propose agreements that are essentially 'cost-plus', with pricing set to deliver a targeted IRR. But again, this approach can leave buyers feeling that they're taking all the risk.
3. *Guaranteed purchases*: Investors want to be sure that your offtake agreements are solid – that there are few, if any, 'exit ramps' that would allow the buyer to avoid buying. One way to approach this is with 'take or pay' provisions, where buyers have to pay for the committed volume whether they take delivery or not. A variation of this is a 'take-or-pay-overhead' clause, that has the buyer only cover the costs for debt repayment, staff, etc, but not any variable costs associated with the foregone volume. Yet another variation is allowing the producer to sell any declined volume to another party, with the original offtaker needing to make up any difference in purchase price. Often, though, your buyers will want some type of out, especially during periods of unusually high prices or low demand – which runs counter to the security that investors are looking for.

Getting quality offtake agreements is key. An investment banker in this field recently shared their view that the biggest issue they run into with clients is when their offtake agreements are just not solid enough to secure financing. In such a case, they recommend that it's better to wait and get better contracts than to waste their time and credibility.

And, the devil is in the details. "The details surrounding price, product testing, take and pay, termination and defaults, among others, really count in these offtake agreements," said John Kirkwood, partner at Faegre Drinker, which has provided legal support for over 100 renewables-related transactions. "Even clauses that seem innocuous and unlikely to be exercised may be interpreted by investors through a worst-case lens, so it's important to avoid potentially problematic terms."

Practical tips for bridging investor requirements with buyer concerns

Building in terms that remove risks for investors is a great idea, and will simplify your fundraise – but is fundamentally at odds with what the procurement officers at your buyers want to commit. That's likely true even if you have committed strategics as your first likely offtakers – they're still looking for agreements that make financial sense and limit *their* risk. Here are some ways you can bridge the gap:

1. *Build shared understanding*: If your buyers really want your product, then you can help them understand what it takes to get a project financed. "We connected Southwest Airlines directly to our bankers," said Nick Andrews, CEO of USA Bioenergy, a producer of advanced biofuels. "Hearing their experiences had a direct impact on important offtake terms."
2. *Secure high-profile buyers early in the process, and promote them:* This has multiple potential benefits, both in securing financing if needed and in spurring other buyers to lock-in capacity. For example, Qore (a joint venture of Cargill and HELM) is building a commercial bio-based BDO plant in the U.S. (based on Geno's technology). They've already announced partnerships with Lycra, for bio-based spandex; and with BASF – both high-profile names.
3. *Incentives for longer term*: Make it worth their while to commit to a longer term than they're used to. You can likely provide small but meaningful discounts that give them a reason to make longer commitments while only reducing your expected project IRR by a bit.
4. *Incentives for greater volume*: The same thinking applies to volume. You want solid commitments for at least 70% of your planned capacity as soon as possible. Baseload your plant by giving modest incentives to those first buyers.
5. *The early bird gets the worm*: Buyers that commit early often feel like they're taking much of the risk – and deserve special benefits. Give it to them – such as with most-favored pricing clauses. But importantly, benefits should only accrue to those that meet specified performance criteria.
6. *Share the risk during higher cost periods*: No one wants to buy on a cost-plus basis with no ceiling. One approach is to reduce your plant's returns during those times to lessen the cost increases for your customers – while still delivering investor-acceptable numbers.
7. *Show that you'll reduce costs over time*: Show that you have a roadmap to continually improve your processes and reduce costs. That's especially important if you're structuring cost-plus agreements.

Start early, keep on it

It's tough to come up with terms that are investor-acceptable for FOIK projects but that procurement officers will sign up for. But keep on it: the tips above are meant as practical advice to that end.

And while the focus here has been on offtake agreements, there are multiple aspects to bringing a successful project to life. To explore some of these broader issues, see my articles on fundraising, messaging and economics.

And remember: the first project is the hardest. Successfully bringing it to life will make it that much easier to deploy projects two and three.

Steve Weiss is co-founder of Grey Heron, a management and strategic marketing consulting firm. Since 1993, the firm has helped executives and investors at over 140 companies build value and become leaders in their sector, through strategy, fundraising, positioning and partnerships. Fields include climatetech, food, advanced materials, and cloud/SaaS/AI. Within renewable chemicals, materials and fuels, Steve has helped build Future Origins, Genomatica (aka Geno), Oberon Fuels, NovoNutrients, Beta Renewables and Liquid Light (acquired by Avantium), and is a proud member of the Due Diligence Wolfpack (watch our sessions on carbon capture, use and sequestration (March 2023), and pivots (October 2022)). Contact Steve at weiss@greyheron.com; see Steve's LinkedIn profile; listen to his "Science of Yes: Positioning and Messaging for Success".

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