KIRKLAND & ELLIS

Blog Post

Energy and Infrastructure Fund Sponsors Have Options in Seeking Liquidity for Portfolio Companies and Investments Amid Market Dislocation

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In the wake of the dramatic drop in oil prices resulting from the ongoing COVID-19 crisis and the Russia-Saudi oil price war, many energy fund sponsors are confronting urgent and substantial liquidity needs for their portfolio companies and investments. In many of these cases, traditional asset-level financing may be costly and/or unavailable, in part due to the increased credit risk in the energy sector. We have seen a number of fund sponsors consider potential alternatives to traditional asset-level financing that are available to address these financing needs and that might be a solution for funds of all types in the broader energy and infrastructure space. These include (1) raising an "annex fund", (2) amending existing fund documents to increase available capital, (3) obtaining a NAV facility, (4) cross-fund transactions and (5) GP-led secondaries.

1. Annex Funds

An annex fund is a new and separate pool of capital, typically raised on an expedited timeline designed primarily to inject new capital into investments held by an existing fund. Investors in an annex fund are often, but not exclusively, existing investors in the existing fund. To alleviate valuation issues, the annex fund may seek to invest in a security more senior to the existing fund (e.g., senior debt or preferred equity). Pursuing this option will require a thorough review of the existing fund's governing documents, and in most situations it will require the consent of the existing fund's limited partner advisory committee and/or its investors.

2. Amending Existing Fund Documents

Some sponsors are seeking to "re-open" their existing funds' governing document to increase available capital, including: (i) increasing the ability to recycle distributable investment proceeds, (ii) expanding the flexibility to incur fund-level indebtedness, (iii) relaxing follow-on and investment concentration restrictions and (iv) increasing capital commitments from investors (including adding a preferred interest), among other changes. It is expected that all of these options would require the consent of the existing fund's investors or limited partner advisory committee, and thus the viability of any of these options depends heavily on the existing investors' appetite for changes.

3. NAV Facilities

"Net asset value" ("NAV") facilities are fund-level credit facilities obtained from a bank or other lender and collateralized by the fund's existing assets. By aggregating the portfolio, this option can provide meaningful additional capital. However, the availability of this option depends on (i) the borrowing limitations in the fund's governing documents and (ii) the willingness of lenders or other financing sources to provide such facilities.

4. Cross-Fund Transactions

A cross-fund transaction involves an investment by another fund managed by the sponsor with an appropriate investment mandate (e.g., fund II investing in a fund I portfolio company). This option almost invariably requires limited partner advisory committee consent of both funds, which is largely dependent on the management of potential conflicts of interest through appropriate standards and processes, including obtaining a third-party valuation.

5. GP-Led Secondaries

Many sponsors are considering whether to exit or restructure some or all of the investments of existing funds into a new vehicle with a combination of new capital and "roll-over" of existing capital. These transactions are becoming increasingly popular in the LBO community, and we expect them to gain consideration and traction in the energy and infrastructure space in the near future because they give sponsors the opportunity to reset economics with existing investors while providing investors with liquidity. However, the pricing of investments of existing funds will remain extremely challenging until the market stabilizes and, furthermore, these transactions often involve a lengthy process. For these reasons, these transactions are not particularly helpful to address near-term financing issues, although they can provide long-term liquidity solutions.

Which option is best?

There are several factors and practicalities a fund sponsor must consider before pursuing any of the above strategies. Whether an option is appropriate for a particular sponsor and/or its investments will be highly dependent on the sponsor's situation, including investor receptiveness, contractual framework of the fund documents and/or availability of third-party financing sources. We encourage fund sponsors to consult with Kirkland's investment funds group in evaluating the viability of any such liquidity solutions.

Read more insights from Kirkland's Energy & Infrastructure blog.

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Matt Nadworny, P.C.

Partner / Houston / Dallas

Laura M. Stake

Partner / Houston

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