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What to know about raising capital in the oil and gas industry

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Operating in any sector of the oil and gas industry is capital intensive. Despite the market downturn and industry consolidation, numerous types of funding remain available to companies in the oil and gas industry.

Here are four things to know about raising capital in the exploration and production and midstream sectors.

SPIDERSTOCK
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Key financing options employed in the oil and gas industry

Three general categories of financing are available:

Equity financing, including IPOs, capital calls and shareholder loans
Third-party financing, including reserve-based lending, acquisition financing, project financing, bridge loans, term loans, capital markets, high yield/hybrids and hedging
Asset dispositions

Exploration and production sector

Prior to the 2014 downturn in the oil and gas industry, the rapid expansion of oil and gas production was fueled by low interest rates, easy access to low-cost debt and high oil prices. Exploration and production companies funded their cash-flow deficits with billions in debt.

Reserve-based lending was instrumental in providing exploration and production companies with low-cost debt financing. The reserve-based lending structure is a bank-syndicated revolving credit facility secured by the company's proved oil and gas reserves. The downturn put reserve-based lending to the test. Numerous bankruptcies caused financial institutions to add provisions to better protect their interests. Lenders also became more selective, looking for strong management teams with financially sound track records and quality assets.

Exploration and production companies with well crafted hedge programs have been somewhat protected against the impact of low oil prices, leading many lenders to now require that a portion of production be hedged.

While additional sources of capital have come from private equity/alternative lenders in the form of joint ventures, term loans, holdco loans and preferred equity, reserve-based lending remain king in the E&P space.

Midstream/infrastructure

Midstream is the largest oil and gas sector in the U.S. Its growth resulted from private equity and infrastructure expanding investments beyond the traditional "core," such as roads, power, airports and rail.

Financing structures in the midstream space have been driven by the need for increased leverage. The development of new pipelines and gathering systems require extensive capital during lower EBITDA periods. In order to support the need for increased leverage, financial institutions and private equity firms utilize hybrid term loan B structures which were historically used in the power and renewables space. With the term loan B structures come cash-management covenants and project finance type waterfalls.

In addition to term loans, the midstream market continues to find financing success with mezzanine and holdco debt, preferred share issuances and private placements which allow for capital to be invested by insurance companies and foreign investors.

Current trends

Volatility is creating uncertainty in the market, and capital is sitting on the sidelines.

Buyers are looking for discounts on assets because of volatility, while sellers are not yet inclined to sell at a discount.

Due to the uncertainty, companies are focused on their best assets and working to operate within their cash flow rather than expanding. Recent surveys suggest cash from operations and joint ventures will make up almost half of the capital spent in 2019, with a little over 20 percent coming from traditional bank debt. Companies without cash flows from operations are more likely to face challenges in obtaining funding.

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