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The Next Big Thing for Companies Outside the US: US IPOs Using a Yield-oriented Structure

Ten practical considerations can help companies around the world tap the significant US capital market with IPOs.

Investors in the United States continue the search for yield. Over the past several years, over 60 companies with operations in the US have gone public either as master limited partnerships (MLPs) or yieldcos. Over this same period, seven companies with operations exclusively or predominantly outside the US have gone public in the US using the same structures. We currently see significant interest in these yield-oriented structures from companies outside the US, particularly in Europe and Asia. The expansion of the US yield-oriented market to companies with assets predominantly outside the US could be a significant growth area over the next five years. This article examines some of the typical characteristics of these types of vehicles and provides some practical guidance for non-US companies considering these structures.

Overview

The total equity market capitalization for master limited partnerships and yieldcos in the US now exceeds US$600 billion. The companies participating in this market have operations focused on the energy industry and represent all segments of the energy value chain — upstream, midstream and downstream. This market's origins can be traced to tax reforms in the US during the mid-1980s when special exceptions from corporate taxation were included in the US tax code for publicly traded partnerships engaged in hydrocarbon-based energy activities (so called "master limited partnerships" or "MLPs"). For many years, this market was unavailable to companies engaged in renewable energy projects. Although renewable companies are still unable to become traditional MLPs, these types of companies are using creative financing techniques to develop a similar yield-oriented vehicle and to target the same types of investors (so called "yieldcos").

Investors are typically focused on total return; that is, stable and growing quarterly distributions of available cash and appreciation in stock price over time. This dynamic has compressed yields while at the same time expanding the market for these types of investment vehicles. This broader market has now attracted a diverse universe of companies (see Exhibit A). Although historically dominated by US companies, more and more non-US companies outside the US are seeking to access this market to fund their capital needs. The international shipping companies were the first non-US companies to identify the potential of this market. These companies viewed their ships or "floating assets" as ideal candidates for the MLP structure because these assets typically traverse the globe under long-term contracts with creditworthy counterparties and do not have any US ports of call (and thereby do not incur US taxes). More recently, VTTI Energy Partners LP went public as the first MLP with fixed assets (refined products terminals) substantially outside the US (largely in Europe, the Middle East and Asia). Similarly, Abengoa Yield plc recently completed its initial public offering as a yieldco with an asset base consisting of renewable energy, conventional power and electric transmission lines on three different continents (North America, South America and Europe).

Common Characteristics

The following chart identifies common characteristics of MLPs and Yieldcos.

	MLPs		Yieldcos	
	US	**Non-US**	**US**	**Non-US**
Type of entity	Partnership or limited liability company	Partnership or limited liability company	Corporation	Corporation
Jurisdiction of organization	Delaware	Marshall Islands (essentially identical to Delaware law)	Delaware	England and Wales (though jurisdiction could vary depending on tax considerations)
Taxed as a corporation	No	Yes	Yes	Yes
Reliance on net operating losses to offset US income taxes	No	No (reliance on lack of US contacts to minimize US taxes)	Yes	Yes (but, for on-US companies, lack of US contacts should minimize US taxes)
Limited to energy-related activities	Yes (required by tax code)	Yes (but no obligation to do so)	Yes (but no obligation to do so)	Yes (but no obligation to do so)
Entity establishes a minimum quarterly distribution	Yes	Yes	Yes	Yes
Entity provides a forecast at IPO of its ability to pay the distribution	Yes	Yes	Yes	Yes
Sponsor retains control	Yes	Yes	Yes	Yes
Sponsor receives an increasing percentage of distributions above certain levels	Yes	Yes	Sometimes	Sometimes
Sponsor provides a limited indemnity	Yes	Yes	Yes	Yes
Type of annual federal income tax statement to US investors	Schedule K-1	Form 1099	Form 1099	Form 1099

Practical Guidance for Companies Outside of the US Launching Yield-Oriented Structures

For companies outside the US considering accessing the US capital markets through a yield-oriented vehicle, we outline some practical guidance as you consider your options:

- **Tap a Broad and Deep Market**: The US market for MLPs and yieldcos has become very large, with over US$600 billion in equity market capitalization spread over 130 companies. This market attracts some of the largest institutional investors as well as healthy interest from US retail investors. There are tremendous opportunities for efficient capital raising activities in this market.

- **IPOs Take Time**: The entire process for a US-listed initial public offering takes from six to nine months, but sometimes longer depending on the particular facts and circumstances of the individual issuer (*e.g.*, tax planning and any restructuring necessary to effect the offering). Advance planning and dedicated personnel are critical to a smooth process and a successful IPO.

- **Focus on Contracts, Counterparties and the Growth Story**: In order to achieve the best (*i.e.*, lowest) yield, you should focus on the following:
  - Contract duration – Is your contract duration long enough to give investors confidence in the stability of your distributions? Typically, average contract duration is at least three and as long as 20 years.
  - Creditworthy counterparties – What is the likelihood of default and/or nonperformance by your counterparties and, in such circumstances, what would any recourse look like? Are your customers investment grade or near investment grade? How do you tell the customer story?
  - Growth prospects – Investors are typically focused on “total return” when evaluating an MLP or yieldco investment. Will the sponsor retain sufficient assets and be properly aligned with IPO investors to foster the future growth of the IPO entity? If so, and the “drop down” story is properly described in the IPO prospectus, the prospects of a successful offering increase dramatically.

- **Think Beyond Energy**: With limited exceptions, domestic MLPs must be focused on the hydrocarbon-based energy industry. This focus has also been present in MLPs and yieldcos involving companies outside the United States. However, non-US companies without US assets do not pay US corporate income taxes. As a result, they do not need to comply with complex rules to avoid US corporate income taxation as would be the case for US-based MLPs and yieldcos. If you have the right contract duration, creditworthy counterparties and growth prospects, you may be able to take advantage of the US yield-oriented capital markets.

- **Get an Early Start on the Tax Planning**: Domestic MLPs must comply with a complex set of rules adopted by the US federal tax authorities regarding “qualifying income” to ensure US MLPs are not taxed as corporations. Non-US MLPs and all yieldcos are taxed as corporations and, thus, those qualifying income issues are not present. However, this does not mean that the tax considerations are not equally as significant. For non-US MLPs, the focus is on (1) minimizing US connected income (which is zero if there are no operations in the US) and (2) minimizing tax in jurisdictions where the assets are located. Yieldcos typically use net operating losses and/or the same strategies as non-US MLPs to minimize future income taxes. Efficient tax planning obviously leaves more cash available for distribution to investors and often translates into a lower yield (and thus a higher valuation).

- **Review your Debt Instruments and Obtain any Necessary Consents**: The most efficient capital structure almost always involves the use of debt, and the instruments governing that debt frequently contain limitations on the borrower's activities. Companies must review these instruments and often must obtain one or more consents to create an MLP or yieldco. Companies should also plan for a lender's "learning process," particularly for lenders outside the US who are not familiar with yield-oriented structures.

- **Financial Statements are Almost Always the Gating Item**: MLPs and yieldcos often consist of a portion of a larger set of the sponsor's assets. In order to go public, an issuer must evaluate and prepare the necessary financial statements for the assets in the IPO entity, which must be audited. As with all financial statements, the process is complicated, involves numerous third parties and takes time. The process is even more complicated if you have recently acquired significant assets for which financial statements will be required. For this reason, the financial statements are almost always the gating item. The following are common financial statement issues:
  - After consulting with your investment bankers, you may decide to convert your financial statements to IASB IFRS or US GAAP. You may prepare your financial statements in accordance with local GAAP/non-IASB IFRS but you must reconcile your financial statements to US GAAP.
  - You will need a Public Company Accounting Oversight Board audit (*i.e.*, US GAAS standards).
  - Your auditor will need to meet complex US independence standards.
  - You should engage with your auditor early and make sure they are speaking with their US SEC specialists.
  - You will need to provide financial statements of any recent significant business acquisitions (>20%).

- **Don't Fear SOX**: The Sarbanes-Oxley Act (SOX) caused some companies outside of the US to abandon or defer a US listing when it was adopted in 2002. Over the past decade, issuers (both US and non-US) have developed processes for dealing with SOX compliance. SOX can be managed, and should not preclude you from considering the US capital markets.

- **Don't Fear the SEC**: As with SOX, many companies irrationally fear the US Securities and Exchange Commission's process for registration statement review. The SEC's mission is to protect investors, maintain fair, orderly and efficient markets, and facilitate capital formation. An important part of that mission is the SEC's review of a registration statement filed in connection with an initial public offering. This review will result in comments from the SEC and changes to your initial registration statement, which is all normal. But, as described in the SEC's mission statement, the SEC exists to facilitate capital formation, not to prevent capital formation. The SEC staff is usually reasonable, the comments are typically helpful and the process is not something to be feared.

- **Take Advantage of the Benefits**: Foreign private issuers enjoy several benefits unavailable to domestic issuers. These include:
  - Ability to use US GAAP, IASB IFRS or local GAAP (but reconciled to US GAAP)
  - Quarterly reports (*i.e.*, Form 10-Q) are not required
  - Current reports on Form 8-K are not required; instead, current reports on Form 6-K are furnished
  - Additional time to file annual reports (four months for non-US issuers as compared to 60 to 90 days for US issuers, depending on size)
  - Financial information goes stale more slowly
  - Exempt from proxy rules, Regulation FD and Section 16 (short swing profit rules)
  - Exempt from limited aspects of SOX

While MLPs and, more recently, yieldcos have become common in the US, many outside the US are largely unfamiliar with these structures. However, the flexibility and access to capital available through these structures should result in a meaningful increase in both the number and size of yield-oriented IPOs by international companies that will launch in US capital markets.

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This article is one of a series that examines trends in the oil and gas industry. For further information on MLPs and Yieldcos, please visit the Latham MLP Portal which now includes a section on Yieldcos. Visit www.lathammlp.com.

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10 Offshore MLP Facts

10 MLP Governance Facts

Issues and Complexities: Evaluating an MLP at 4 Key Points in the IPO Process

Exhibit A

Examples of Companies Currently Using a Master Limited Partnership or Yieldco Structure

MASTER LIMITED PARTNERSHIPS

Natural Gas Compression
Natural Gas Storage
Exploration and Production
Pipelines, including:

Crude oil pipelines (transmission and gathering)
Natural gas pipelines (transmission and gathering)
Refined products pipelines

Crude Oil and Refined Products Terminals
Mining
Propane
Refining
Shipping, including:

LNG carriers
LNG regasification vessels
Drilling rigs
Drillships
LPG carriers
Crude oil carriers

Oilfield Services, including:

Fuel processing and distribution
Frac sand
Saltwater disposal
Water and environmental services
Wholesale distribution of motor fuels

Timber
Other, including:

Fertilizer
Soda ash production
Methanol and ammonia production
Propylene production
Ethylene production facilities
Cokemaking facilities

YIELDCOS

Conventional Power
Electric Transmission Lines
Renewables, including:

Wind Farms
Concentrating Solar Power
Thermal Generation

Hydro Electric Power