KIRKLAND & ELLIS

JANUARY 2020

Structuring Solutions in Challenging Times

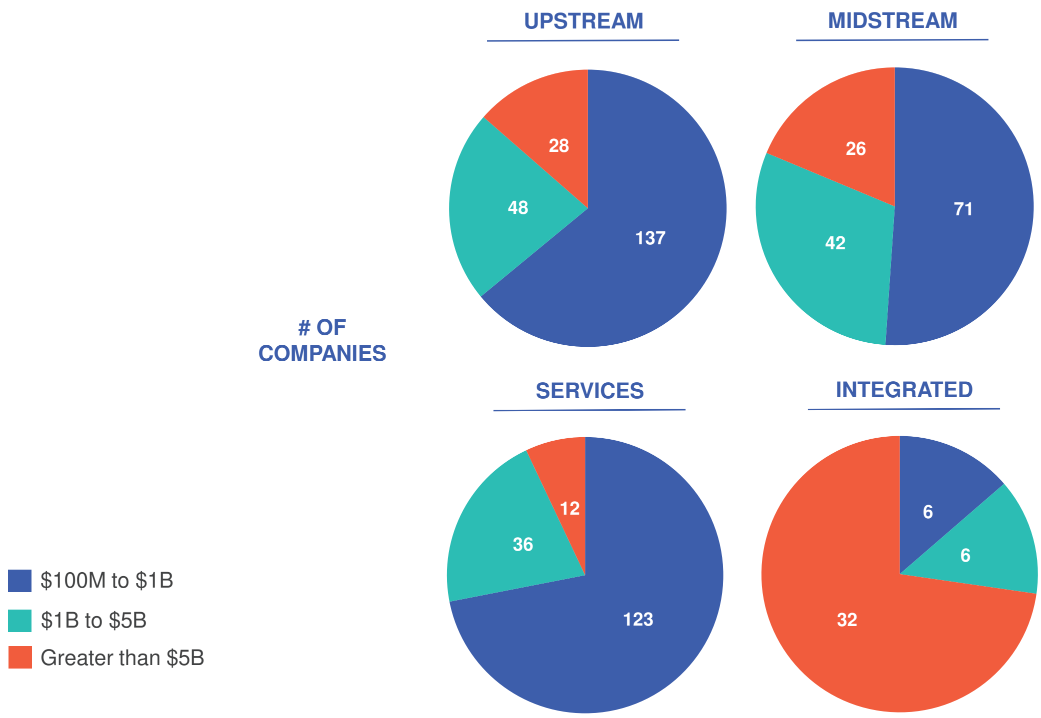
Sector Observations

Increasing focus on potential sector consolidation

	Upstream	Midstream	Services
Relative Underperformance	Long-term underperformance and high volatility Equity investors shifting focus (and capital) away from each sector; especially generalists investors Focus on ESG and climate-related risks factoring into underperformance.		
Industry in Transition	▸ Pivoting from resource capture to resource exploitation ▸ Operational and cost efficiencies are in focus, much like other manufacturing sectors	▸ Simplification and C Corp conversions are nearing completion ▸ Tax reform cloud has lifted	▸ Highly fragmented mid- and low-cap market under increased pressure to consolidate ▸ Technology-driven efficiencies driving bidding process
Financial and Operational Considerations	▸ Ability to execute and finance full-scale development is now a competitive necessity ▸ Cost of capital advantage compounds benefit of lower operating costs ▸ Public equity markets are not often valuing long-term capital intensive projects ▸ A number of companies remain overlevered and financially vulnerable	▸ Self-funding (higher coverage payouts) are the norm ▸ Deleveraging remains a critical goal, with more non-core asset sales expected to accelerate the process ▸ Investors concerned about dividend cuts at many MLPs	▸ Pricing pressure remains significant and revenue recovery lags behind commodity prices ▸ Excess capacity, particularly in pressure pumping and frac sand ▸ A number of companies remain overlevered and financially vulnerable
Focus on Capital Return	▸ Investors demand consistent and visible excess free cash flow generation ▸ Investors anticipate greater returns of capital to stockholders	▸ Unit buybacks potentially an opportunity for some strong MLPs to support valuations ▸ Investors anticipate greater returns to unitholders	▸ Investors prioritize near-term strength in underlying fundamentals over those with longer-dated recoveries

Sector Observations: Public Company Market Players

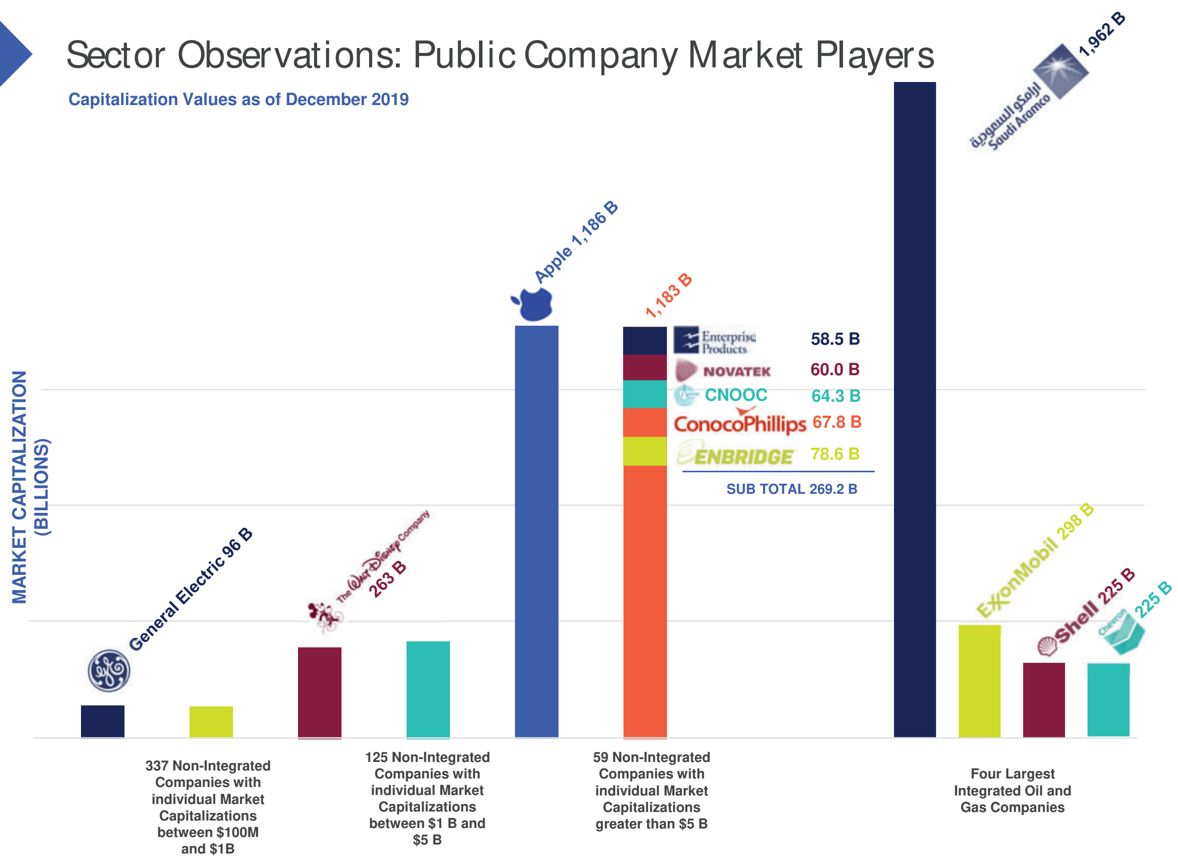
January 2020



*Publicly-traded companies with equity market capitalization of $100 million or more.
Sources: S&P Cap IQ, January 2020.

Sector Observations: Public Company Market Players

Capitalization Values as of December 2019



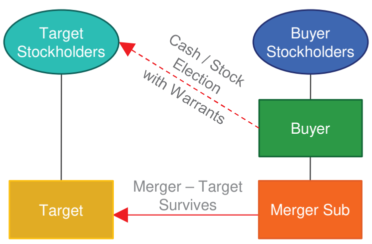
*Publicly-traded companies with equity market capitalization of $100 million or more.
Sources: S&P Cap IQ, December 2019.

Bridging M&A Valuation Gaps

Warrants

Kinder Morgan, Inc. (KMI) and El Paso Corporation
October 2011
$37.8 billion (including net debt assumed)

KINDER MORGAN elpaso



Background

- KMI first approached El Paso about a possible combination of the two companies in 2010
- 2011 saw strong oil prices while natural gas prices weakened further as new supplies surged
- El Paso owned North America's largest natural gas pipeline system and was seeking to spin off its E&P business

Issue

- On September 18, 2011, KMI and El Paso preliminarily agreed that a price of $27.55 per share in cash and KMI stock could be a basis for further negotiation
- On September 25, 2011, KMI became concerned that the assumptions underlying its valuation of El Paso were too aggressive

Solution

- Parties used warrants to bridge the valuation gap, eventually agreeing that each El Paso share would receive, at the election of the holder but subject to proration, either: (1) 0.9635 of a KMI share and 0.640 of a warrant to purchase one KMI share; (2) $25.91 in cash and 0.640 of a warrant to purchase one KMI share; or (3) 0.4187 of a KMI share, $14.65 in cash and 0.640 of a warrant to purchase one KMI share
- Each warrant had an exercise price of $40.00 per share of KMI stock and a term of five years
- KMI shares were trading at $26.89 on the date prior to the announcement of the transaction
- The parties agreed that each warrant had an indicative value of $1.50 as of the date prior to the announcement of the transaction
- Following the closing, KMI immediately began repurchasing warrants, eventually repurchasing approximately 42% of the outstanding warrants for $732 million (approximately $3.45 average price paid per warrant)
- Approximately 58% of the outstanding warrants expired unexercised on May 25, 2017

Considerations

- Does the charter authorize sufficient capital stock to deliver the securities underlying the warrants? Amending the charter to provide for additional capital stock typically requires stockholder approval
- Both the NYSE and NASDAQ require stockholder approval (by a majority of the shares present at the meeting) in connection with issuances of securities convertible into or exercisable for common stock, if the common stock will upon issuance equal or exceed 20% or more of the common stock or voting power outstanding before such issuance

Title search: Structuring Solutions in Challenging Times

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