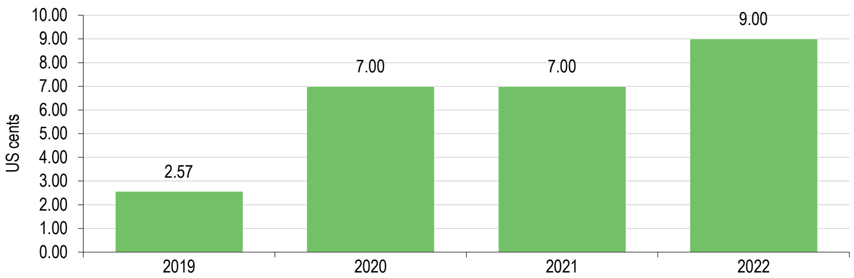
Riverstone Credit Opportunities Income

High yield on the energy transition

Investment companies

Riverstone Credit Opportunities Income (RCOI) posted a healthy NAV total return (TR) of 14.5% in FY22, benefiting from rising base rates, as well as seven full exits (realised at an IRR of 14.3–32.5%) and six new investments resulting in the recognition of call premiums (exits) and upfront fees (investments). RCOI's focus on short-duration lending allowed it to swiftly rebalance its portfolio to energy-transition focused investments. The process is now complete, with over 95% of the end-2022 portfolio being either green loans or sustainability-linked loans (vs c 35% at end-2021).

Solid income generation allowed RCOI to raise its dividend per share



Source: Company data

Why invest in RCOI now?

In the current high interest rate environment, RCOI offers attractive income from a portfolio of loans that are all floating-rate, first-lien and asset-backed and bear an average margin over the Secured Overnight Financing Rate (SOFR) of 800bp. The recent hikes in the Federal Reserve's target rate (driving the current SOFR to c 4.80%) translated into strong income for RCOI and in turn a solid dividend of 9 US cents per share for FY22, which given the current discount to NAV represents a c 10% dividend yield.

The analyst's view

RCOI was 102% committed at end-2022 and approaching 100% invested. In order to optimise its capital deployment while at the same time provide liquidity for future obligations such as capital calls and ongoing expenses, RCOI's special purpose vehicles (SPVs) entered into a US$15m revolving credit facility (RCF) in December 2022. RCOI's investment manager highlighted that it has a rich investment pipeline with nine primary deals (green or sustainability-linked loans) representing US$720m in commitments. The manager believes that RCOI is well positioned to benefit from growing demand for energy sources coupled with the need of the energy industry to meet global 'net-zero' targets.

Valuation: Discount to NAV of c 20%

RCOI currently trades at a c 20% discount to NAV. This is despite a relatively benign outlook for the oil and gas industry, the continued solid performance of the portfolio and a good dividend stream.

NOT INTENDED FOR PERSONS IN THE EEA

13 April 2023

Price	**US$0.89**
Market cap	**US$81m**
NAV*	**US$98m**
	US$1.25/£
NAV per share*	US$1.08
*As at 31 December 2022.	
Discount to NAV (cum fair)	20%
Dividend yield	10.0%
Ordinary shares in issue	90.8m
Code	RCOI
Primary exchange	LSE Specialist Fund Segment
AIC sector	Sector Specialist: Debt
Gross gearing as % portfolio value*	5.2%

*Estimated end-2022.

Fund objective

Riverstone Credit Opportunities Income's objective is to generate stable current income and growth in NAV by investing in a diversified portfolio of senior secured loans to mid-market entities predominantly engaged in building infrastructure and providing infrastructure services to generate, transport, store and distribute both renewable and conventional sources of energy, as well as those focused on the transformation of the global energy sector from fossil-based to zero carbon. There is a focus on US companies, but RCOI invests across end-markets to provide synergies and hedges to enhance portfolio stability.

Bull points

- Lending niche with barriers to entry allows for favourable pricing.
- The loans are floating rate, which is an attractive feature in a rising rates environment.
- Significant re-rating potential given wide discount.

Bear points

- The energy market is highly cyclical and economic uncertainty remains elevated.
- RCOI loans to projects that are pre-revenue can conceivably have higher risk.
- Relatively short fund trading history, although the manager has other similar (but private) energy funds with a 2015 inception.

Analyst

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Edison profile page

Riverstone Credit Opportunities Income is a research client of Edison Investment Research Limited

Market outlook

High capital needs in the energy sector

The energy sector is a considerable borrower given its capital intensiveness, with 2021 global energy investment in the coal, oil and gas and low-carbon fuels supply sector at US$485bn, according to the International Energy Agency. The industry's demand for capital remained high even during times of high volatility in commodity prices, as illustrated by the sector's high share in total capex in 2015 and 2016 despite commodity prices falling by 59% between 2014 and 2015. Importantly, the sector exhibited a default rate of 2.6% in 2001–17 versus 4.9% for non-energy sectors (based on the Fitch US High Yield Default Index). At the same time, historical recovery rates were above average, according to Moody's, which have been supported by lending being predominantly asset-backed.

Non-bank lenders with niche expertise filling the mid-market gap

As credit markets have grown, there is declining interest in smaller and less liquid names. In addition to this, since the financial crisis in 2007–08, banks have been cutting back their lending to several segments to de-risk their portfolios, including middle-market energy (despite its high capital needs). However, non-direct lenders usually do not have the resources and experience to deal with the unique characteristics of energy lending, which requires extremely technical credit analysis (due to the high cyclicality) and sector knowledge. As a result, the energy segment is extraordinarily under-represented in direct non-bank lending. In 2018, while the energy sector represented 26% of bank lending for mid-market US companies, it did not account for even 1% of the non-bank market, according to Refinitiv Loan Connector. This has created a business opportunity for non-bank lenders such as RCOI, with access to specialist teams and deep sector knowledge, to take advantage of the favourable credit supply and demand dynamics.

The overall lending opportunities in the market are augmented by the secular energy transition trend, which, according to McKinsey & Company, will require more than US$500bn in additional capital in the energy sector.

Credit conditions have deteriorated recently…

Rising rates, continued high inflation, tighter credit markets and slowing economic growth put pressure on corporate credit profiles. While the default rate within the Morningstar Loan Syndications and Trading Association (LSTA) US Leveraged Loan Index stood at a relatively low level of 0.85% at end-January 2023, S&P Global Ratings expects US leveraged loan default rates to quickly rise to 2.5% by December 2023 on the back of increased refinancing risk. Similarly, Fitch Ratings raised its US high yield default forecast in January 2023 to 3.0–3.5% from 2.5–3.5% previously (vs 1.3% at end-2022, though in line with the 2001–22 average of 3.6%) on the back of further macroeconomic headwinds, including Fitch's expectations of a US recession in mid-2023 and a mere 0.2% GDP growth in 2023 overall.

Global credit markets have tightened significantly since late 2022, as illustrated by the US leveraged loan market, which saw institutional new-issue loan volumes at only US$35.7bn in Q422, the second-weakest quarterly level in the past decade (according to Partners Group citing Leveraged Commentary & Data, LCD), with most of the issuance coming from refinancing debt with approaching maturity by strong BB-rated issuers. New issue spreads came in at SOFR + 453bp for B/B+ rated issuers (vs Libor + 396bp in Q421). Overall, the average all-in yield on new loans in Q422 was 10.4% (vs 4.82% in Q421), while original issue discounts averaged 96% (ranging from

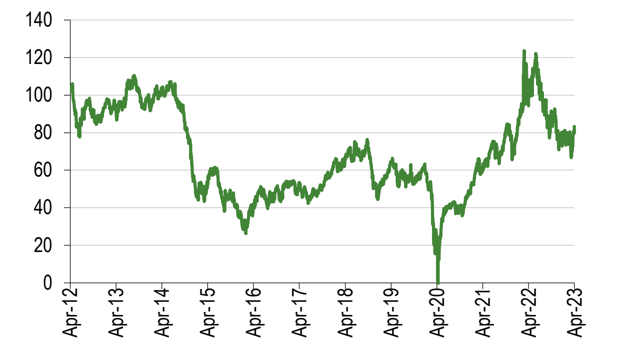
91% to 98%). Leveraged loan issue volumes rebounded only modestly in Q123 to US$49.5bn (still down significantly from US$112.3bn in Q122), with 70% attributable to refinancing, according to PitchBook citing LCD data. High-yield bond markets also experienced a significant slump in new issuances, hitting a 14-year low in Q322, according to PitchBook citing LCD data.

…But high oil prices assisted the oil and gas sector

Although general credit conditions have worsened, high oil prices supported the oil and gas sector in 2022. North American speculative-grade companies rated by S&P Global Ratings active in exploration and production (E&P) and oilfield services (OFS) posted revenue growth in the 12 months to end-September 2022 of 135% and 62%, respectively, with EBITDA margins expanding by 15pp and 4pp, respectively. This translated into a strong EBITDA interest coverage ratio for oil and gas companies of 13.7x and moderate gross debt to EBITDA of 2.0x at end-September 2022.

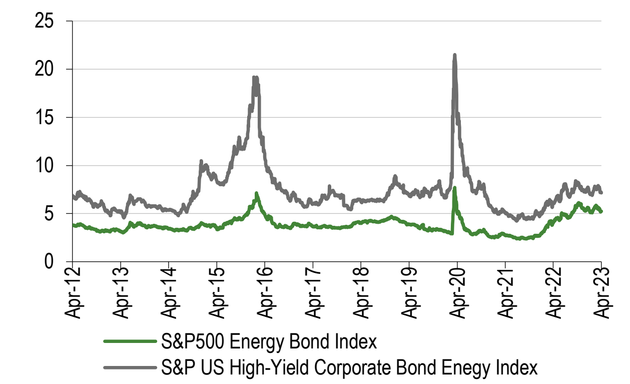
That said, S&P Global Ratings recently highlighted that despite strong hydrocarbon prices in 2022, positive rating actions in the OFS space were muted compared to the E&P sector, as the latter curbed capital expenditure and OFS companies had limited ability to offset material and labour cost inflation. However, S&P Global Ratings highlighted in its January 2023 *Industry Top Trends* report for oil and gas that it has started to see a return in pricing power to OFS companies, driving their margin improvement and debt reduction. S&P Global Ratings forecasts that E&P companies will raise their capex budgets by 15–20% in 2023 (including cost inflation). The ratings agency expects oil prices to remain supportive for the sector's credit quality and considers a sustained drop below US$75 per barrel unlikely in a mild recession scenario. Here, we note OPEC's recent unexpected announcement that it will cut its output by 1.16m barrels per day starting in May.

Exhibit 1: Crude oil (West Texas Intermediate), US$/bbl



Source: Refinitiv

Exhibit 2: Yield to redemption of US energy bonds, %



Source: Refinitiv

The fund manager: Riverstone Investment Group

The Riverstone advantage

RCOI looks well positioned to exploit the opportunities in mid-market energy lending, as it is able to leverage the Riverstone Credit Platform (RCP) and the wider Riverstone group (Riverstone Holdings), which is a key differentiating advantage. Riverstone was founded in 2000 and is a private investment firm focused on energy and power. It has raised US$43bn in more than 200 investments across its four platforms: private equity, credit, decarbonisation and Latin America.

Riverstone is the key source for RCOI's origination and provides support for due diligence, risk underwriting capabilities and credit analyses. It offers access to market specialists and operational expertise, which helps manage risk and provides downside protection. Since July 2014, the RCP has evaluated more than 1,200 direct lending investment opportunities.

Christopher Abbate and Jamie Brodsky head Riverstone Credit Partners and the Riverstone Credit team that manages the platform funds, including RCOI. Both joined Riverstone in 2014 after a decade of leading energy leveraged finance at Citibank and Nomura, respectively. The Riverstone Credit team is made up of 10 people with industry knowledge, financial expertise (including origination, syndication and underwriting) and operating capabilities.

Since 2014, Riverstone Credit Partners has committed c US$2.3bn in capital in RCP I and RCP II energy credit funds, both of them private (unlisted). As is the case with RCOI, these funds consist of floating rate, first-lien loans with similar average tenors and loan-to-value (LTV) ratios (in the mid-40s). RCP has historically achieved a gross internal rate of return (IRR) of 14–17% within the infrastructure and infrastructure services sectors. As a comparison, the five-year average yield to redemption of the S&P US High Yield Corporate Energy Bond Index averaged just under 7% in the five years to the end of 2022.

The manager's view

With the strong backdrop of the energy markets in 2022 and RCOI's unique focus on short-duration lending, the re-balancing of the portfolio to energy-transition focused investments is now complete. Over 95% of the end-2022 portfolio is either green loans or sustainability-linked loans, compared to c 35% at end-2021. The balance of RCOI's portfolio at end-2022 are small equity positions or take-back instruments received from previous loans.

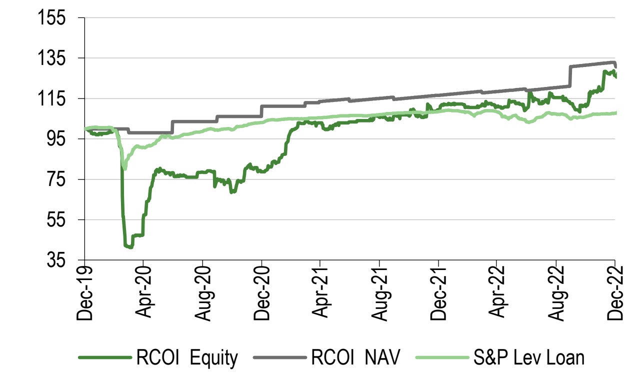
RCOI's investment manager believes that the conditions in the broader energy sector remain buoyant going into 2023. It continues to see a strong pipeline of opportunities and expects to make a number of further commitments across the infrastructure, infrastructure services and energy transition sectors. The manager believes that RCOI is well positioned to take advantage of the convergence of two market trends: consistently growing demand for sources of energy and the concurrent need for the global infrastructure industry to meet 'net-zero' targets. It believes that the fastest and most responsible way to achieve the energy transition is to help decarbonise the existing energy business while building newer, more sustainable energy infrastructure.

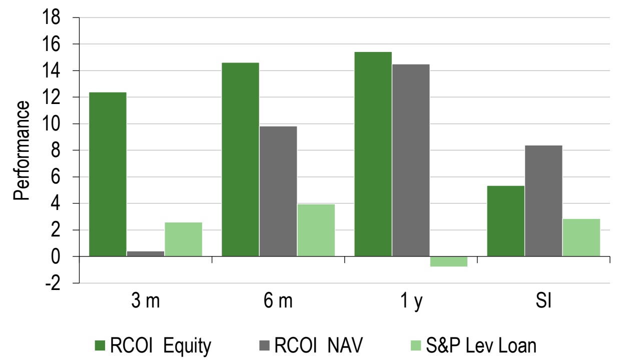
NAV total return of 14.5% in FY22

RCOI posted a strong 14.5% NAV TR in FY22, bringing its NAV TR since inception on 24 May 2019 to 33.7% (or c 8.4% pa), see Exhibit 3. This compares with the TR of the S&P Leveraged Loan Index of 2.8% pa during that period. Part of the outperformance is likely because RCOI's loan investments (unlike leveraged loans included in the S&P index) are normally not actively traded in the market and therefore their valuation is less affected by short-term sentiment swings (though they are marked to market by a third-party valuation agent). That said, RCOI's niche expertise in lending to the mid-market energy sector also likely plays an important role in the outperformance.

Exhibit 3: RCOI's performance to end-2022

Price, NAV and benchmark total return performance, one-year rebased	Price, NAV and benchmark total return performance (%)





Source: Refinitiv, Edison Investment Research. Note: SI=since inception. Inception date is 24 May 2019.

Exhibit 4: RCOI's discrete performance versus selected indices in total return US Dollar terms (%)

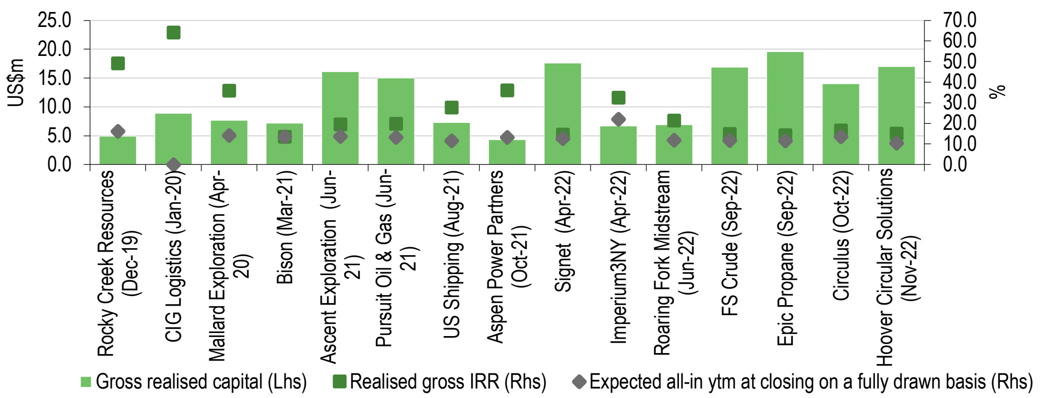
12 months ending	RCOI's NAV	RCOI's share price	S&P Leveraged Loan Index	S&P500 Energy Bond Index
31/12/20	11.1	(21.2)	3.1	6.1
31/12/21	4.9	38.9	5.2	3.3
31/12/22	14.5	15.4	(0.8)	(13.6)

Source: Refinitiv, Morningstar, Edison Investment Research

Here, we note that RCOI's historical return was negatively affected by the period of near-zero Fed funds target rate in 2020 and 2021, as well as the significant cash drag in the initial quarters following its initial public offering (IPO) (see Exhibit 5).

As the majority of RCOI's loan investments get repaid early, the gross IRR it realised on past investments is ahead of the all-in yield to maturity (ytm) expected at closing upon full drawdown (see Exhibit 5). Overall, RCOI achieved a gross IRR of 17.2% on all 16 fully realised investments since inception.

Exhibit 5: IRR versus expected all-in ytm on RCOI's realised investments since inception



Source: Riverstone Credit Opportunities Income data. Note: Realisation date indicated in brackets in the X-axis labels.

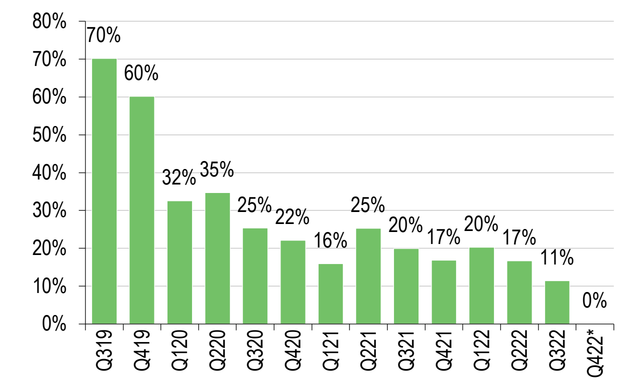
Given that RCOI's investment portfolio is 100% floating, its income benefited from the increase in market interest rates alongside expectations for Fed rate hikes in 2022, with the SOFR up from close to nil at end-2021 to c 4.30% at end-2022 (and c 4.80% currently).

This was accompanied by a gradual reduction in dry powder, with RCOI's gross cash as a percentage of NAV down from 17% at end-2021 to 0% at end-2022 (see Exhibit 6). RCOI's high investment level was facilitated by the RCF that its SPVs recently entered into (see below for details), as well as secondary purchases (Hoover Circular Solutions and Seawolf Water Resources).

RCOI also likely recognised some call premiums on repaid loans (Circulus, Hoover Circular Solutions), and potentially also upfront fees booked on some of the new investments in Q422 (Hoover Circular Solutions, Clean Energy Fuels, Max Midstream). RCOI's standard loan terms involve either an upfront fee (recognised immediately in its P&L) or an original issue discount (OID), which is recognised gradually over the term of the loan (weighted average upfront fee/OID for the end-2022 portfolio stood at 2.5%).

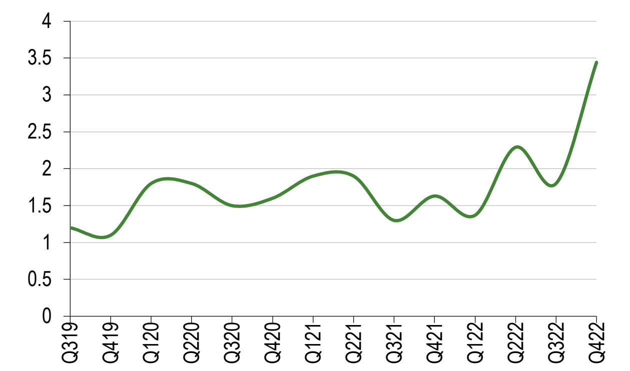
Consequently, RCOI's net quarterly revenue profit (calculated as holding-level investment income, as well as minor interest income, less total expenses) reached US$3.4m in Q422 (representing c 39% of FY22 net revenue profit of US$8.9m) compared to US$1.6m in Q421 (see Exhibit 7). Overall, RCOI's net profit in FY22, including fair value movements of the fully-owned SPVs that it invests through, reached US$12.8m, up significantly from US$4.4m in FY21 and US$7.4m in FY20.

Exhibit 6: RCOI's uncommitted cash balance as a percentage of NAV



Source: Riverstone Credit Opportunities Income data. Note: *RCOI gross committed capital stood at 102% of portfolio value.

Exhibit 7: RCOI's quarterly net revenue profit (US$m)



Source: Riverstone Credit Opportunities Income data. Note: Net revenue profit defined as investment income (and minor interest income at holding level) less total expenses.

RCOI highlighted on 9 December 2022 that the average margin over SOFR across its portfolio stood at 800bp. We note that the coupon rate on most of RCOI's loans is reset (based on the prevailing Libor/SOFR) on a quarterly basis. Given the increase in SOFR from the end-September 2022 level of c 3%, we believe that RCOI's coupon income has further growth potential in H123. For instance, at the current SOFR, the Streamline loan bears a coupon of c 12.80% (versus the weighted average drawn coupon at entry across RCOI's portfolio of 9.64% at end-2022). This also compares favourably with the effective yield of the ICE BofA US High Yield Index of c 8.3% as at 11 April 2023.

That said, further upside in terms of the Fed's target rate may be limited as, according to the CME FedWatch tool as at 13 April 2023, the market expects that the peak rate will not exceed 5.00–5.25% in 2023, with the highest probability for the December 2023 meeting at 4.25–4.50% (36.1%).

Peer group comparison

Exhibit 8 shows a comparison of RCOI with a selected peer group of funds from the AIC Sector Specialist: Debt sector that have significant holdings in direct lending or similar investments. We note there is no pure energy direct lending peer; RCOI is unique. RCOI was the top performer over one and three years to end-2022 (longer-term returns are not available given that RCOI's inception date is 24 May 2019). RCOI is currently trading at a discount to NAV of 19.7%, slightly wider than peer average (narrower than that for GCP Asset Backed Income, but wider than that for BioPharma Credit). Its current dividend yield is somewhat higher than peer average. RCOI's target dividend yield of 8–10% on its IPO price compares with BioPharma Credit's target of a 7% dividend yield on its IPO price (BioPharma Credit targets a total return of 8–9% pa).

Exhibit 8: Selected investment peer group at 13 April 2023* in sterling terms

% unless stated	Market cap £m	NAV TR 1 year	NAV TR 3 year	Premium/ (discount)	Ongoing charge	Perf. fee	Net gearing	Dividend yield
Riverstone Credit Opportunities	**64.8**	**27.9**	**45.4**	**(19.7)**	**1.5**	**Yes**	**101****	**10.0**
BioPharma Credit	1,019.7	24.6	35.4	(5.6)	1.1	Yes	100	7.3
GCP Asset Backed Income	308.0	3.4	13.8	(24.3)	1.2	No	99	8.8
VPC Specialty Lending Investments	217.6	(7.0)	31.9	(20.7)	2.4	Yes	140	10.2
Peer average	**515.1**	**7.0**	**27.0**	**(16.8)**	**1.6**	**-**	**113**	**8.8**
Rank	4	1	1	2	2	-	2	2

Source: Morningstar, Edison Investment Research. Note: *Performance to end-2022. **Calculated at the holding level based on the fair value of investments in SPVs, which had US$5m drawn credit and US$6.7m cash balances at end-2022. TR = total return in sterling terms. Net gearing is total assets less cash and equivalents as a percentage of net assets (100 = ungeared).

Asset allocation

RCOI's portfolio has shifted over time away from exploration and production (which made up 57% of the portfolio at end-September 2019) and towards midstream, infrastructure services and energy transition. Its investment portfolio at end-2022 consisted of 10 direct loan investments across infrastructure services (53%), infrastructure (32%) and energy transition (15%) with a gross unrealised value of US$96.4m (see Exhibit 9), which together with the US$12.6m gross realised capital was 12% above the cumulative gross invested capital at end-2022.

RCOI uses the term infrastructure to include both midstream businesses as well as power generation. Examples of midstream include pipelines, terminals and storage. Power generation examples are natural gas fired, solar, wind, hydro, geothermal and nuclear. Infrastructure loans can therefore also be green loans.

Infrastructure services are asset heavy (similar to infrastructure businesses), but are businesses that serve the infrastructure such as transportation, logistics, distribution, construction, maintenance and equipment rental. Unlike infrastructure, infrastructure services will often have assets that move. As with infrastructure, these assets can also contribute to the transition to net-zero energy solutions.

RCOI classifies energy transition businesses as those that aid the transition of a carbon-based energy world to one of net zero, but do not fit neatly as either infrastructure or infrastructure services. This includes businesses in areas such as conversion of existing infrastructure, electrification of transport, waste-to-value, agriculture and next-generation fuels.

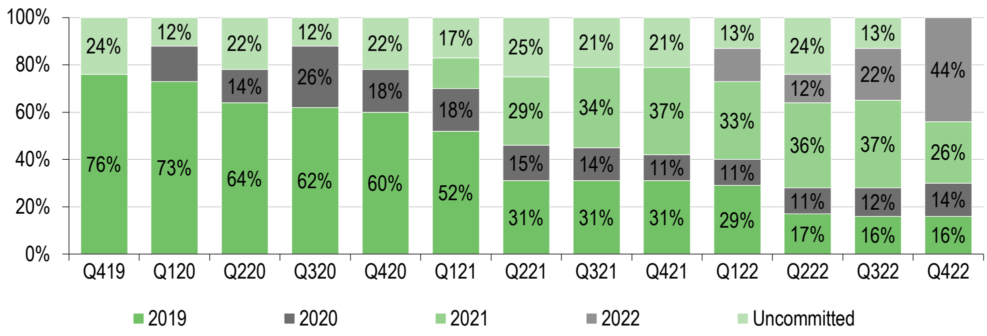
Exhibit 9: RCOI's portfolio at end-2022

US$m Company/project name	Subsector	Commitment date	Cumulative committed capital	Cumulative invested capital	Gross realised capital	Gross unrealised value*	Gross MOIC (x)**	Ytm (%) at entry & fully drawn	% par value
Caliber Midstream	Infrastructure	Aug-19	4.0	4.0	0.5	0.5	0.25	11.8	40.7
Imperium3NY	Energy transition	Apr-21	6.8	5.4	6.7	2.7	1.75	22.1	N/A***
Blackbuck Resources	Infrastructure	Jun-21	11.5	11.0	2.3	10.8	1.18	11.9	100.8
Streamline	Infrastructure services	Nov-21	13.8	6.8	1.0	7.1	1.17	11.1	99.6
Harland & Wolff	Infrastructure services	Mar-22	14.6	14.6	1.2	15.7	1.15	13.2	102.5
Seawolf Water Resources	Infrastructure services	Sep-22	9.0	9.0	0.1	13.0	1.46	10.6	N/A****
Epic Propane	Infrastructure	Sep-22	13.9	13.9	0.5	13.9	1.04	13.8	99.1
Hoover Circular Solutions	Infrastructure services	Nov-22	13.7	13.7	0.1	13.9	1.02	13.9	98.1
Clean Energy Fuels	Energy transition	Dec-22	13.9	13.9	0.1	13.9	1.01	12.0	99.0
Max Midstream	Infrastructure	Dec-22	5.0	5.0	0.1	5.0	1.01	13.3	100.0
Total	-	-	**106.2**	**97.3**	**12.6**	**96.4**	**1.12**	-	-

Source: Riverstone Credit Opportunities Income data. Note: *This is similar to the fair value of the loans. **Gross multiple of invested capital (MOIC) is the total gross realised and unrealised value as a percentage of invested capital. ***Loan was repaid in April 2022; RCOI still held an equity stake from warrants valued at US$2.7m at end-2022. ****The combined fair value of the first-lien term loan, preferred stock and common equity was c US$13.0 at end-2022.

All of the loans are first-lien and secured on assets of the operating company (except for Caliber Midstream, which is secured on the holding company). Investment maturities across RCOI's portfolio tend to be short to medium (the usual tenor is one to four years), with the weighted average tenor at entry of 3.1 years as at end-2022. Furthermore, RCOI often welcomes early redemption as a sign that the borrowers are growing. Therefore, many, if not most, of the loans are expected to have full or partial realisations before maturity (the average actual tenure of RCOI's realised investments since inception is c 1.4 years, according to our calculations), translating into high portfolio turnover (see Exhibit 10). RCOI has executed 24 direct investments and participated in two secondary investments since inception and cumulatively invested US$247m of capital since the IPO in May 2019.

Exhibit 10: RCOI's historical split of committed capital by vintage



Source: Riverstone Credit Opportunities Income data, Edison Investment Research. Note: Refinanced loans are classified as the same vintage as that of the original loan. The Q422 portfolio split accounts for the Epic Propane and Hoover Circular Solutions loans refinanced in 2022 as 2019 and 2020 vintages, respectively.

In FY22, RCOI completed six investments with total committed capital of c US$70m (all of which was already deployed at end-2022), of which two transactions (Epic Propane and Hoover Circular Solutions) were refinancings of earlier loans. These investments represented 44% of total committed capital at end-2022 and allowed the company to become 102% committed and to approach a 100% investment level. RCOI also completed seven full realisations of loan investments in FY22 (including the two above-mentioned refinancings) with total gross realised capital of c US$98.7m, on which RCOI achieved a gross IRR ranging from 14.3% to 32.5% (see Exhibit 5).

Exhibit 11 gives brief descriptions of the various loans as at end-2022, most of which are co-investments with other Riverstone-managed or associated funds, which reflects the leverage of the Riverstone group's expertise and support.

Exhibit 11: Borrower profile (at end-2022)

Caliber Midstream	A sponsor-backed midstream company focused on the Bakken Formation (Montana, Dakotas and Canada) that provides crude oil and natural gas gathering and processing, produced water transportation and disposal, and freshwater sourcing and transportation. Use of proceeds, combined with a RCF draw, was to fund an acquisition. Part of a US$65m loan. Caliber was recapitalised in May 2021 by the RCP and other holding company lenders, resulting in the holding company term loan lenders receiving substantially all of the equity in the holding company. In March 2022, RCOI and the operating company lender closed the restructuring, with the operating company lenders receiving c 100% of the equity. Following the restructuring, new management was hired, a new contract was executed and there remains increased focus on cost-cutting measures and new revenue opportunities.
Blackbuck	A sponsor-backed water infrastructure company focused on providing E&P operators with a one-stop shop for all things related to water management, including treatment, gathering, recycling, storage and disposal. The term loan is Riverstone Credit Partners' first sustainability-linked loan, whereby the loan pricing steps up if certain sustainability targets are not achieved. Part of a US$50m loan.
Streamline Innovations	Sponsor-backed leader in environmentally advanced treatment solutions and equipment for hydrogen sulphide (H_2S) in energy, renewable fuels, wastewater, landfill gas, biogas and industrial processes. Part of a US$45.0m green loan. The loan was initially structured as a sustainability-linked US$20m loan whereby the pricing steps up unless a sustainability target is met that is tied to new construction of H_2S treating plants, which eliminate poisonous H_2S gas and reduce toxic sulphur dioxide emissions by eliminating routine flaring.
Harland & Wolff	Certified green-term loan to a publicly listed infrastructure operator engaged in the development and operation of strategic maritime assets in the UK. Proceeds from the term loan will be used to fund working capital and capital expenditures associated with the fabrication of wind turbine generator jackets for an energy offshore wind project, to repay existing indebtedness, to fund an interest reserve account, and to pay transaction fees and expenses. There are two tranches: committed (US$35m) and uncommitted (also US$35m in size). The deal includes detachable share warrants.
Seawolf Water Resources	A sustainability-linked loan to a privately held water infrastructure services company with operations primarily in Loving County, Texas, and southern New Mexico. The investment includes a first-lien term loan along with preferred stock and common equity, collectively at a significant discount to market value.
Epic Propane Pipeline	A sponsor-backed infrastructure company that will provide propane purity offtake transportation to the Houston (Texas) export market. Use of proceeds from the sustainability-linked credit facility is for the construction of a new propane pipeline from Robstown and Corpus Christi to Sweeny (Texas). Part of a US$77m loan.
Hoover Circular Solutions	A sponsor-backed company that is the leading speciality rental provider of containers and mobile asset management solutions across the energy, industrial, refining and petrochemical industries. Proceeds to completely refinance the existing capital structure. Part of a US$225m loan. Previously referred to as Project Boulder. RCOI increased its commitment by US$8m on similar terms.
Clean Energy Fuels	A sustainability-linked loan to the largest provider of renewable natural gas (RNG, made from organic waste) for the North American transportation market. It has a network of more than 550 fuelling stations across the United States.
Max Midstream	A sustainability-linked loan to a subsidiary of Max Energy Industrial Holdings developing the first carbon-neutral crude oil export terminal on the Gulf Coast of Texas, which it believes will lead to increased market share as crude consumers globally seek to reduce their overall carbon footprints.

Source: Company data

Pursuing a rich investment pipeline

RCOI's manager highlighted that the team is pursuing nine primary deals representing c US$720m in commitments, including c US$400m of sustainability-linked loans and US$320m related to green loans (see Exhibit 12).

Exhibit 12: RCOI's current investment pipeline

Date	Project name	Type of company	Total deal size (US$m)*	Equity ownership	Description	GL/SLL**
Nov-22	Purity	Infrastructure	35	Private	Helium	SLL
Jan-23	Sandy	Infrastructure	100	Private	Silica extraction	SLL
Jan-23	Nitro	Infrastructure	150	Sponsor	Greenhouse gases to biomaterial	SLL
Jan-23	Trident	Infrastructure	120	Sponsor	Battery energy storage systems	GL
Jan-23	Zeus	Infrastructure	50	Private	Battery manufacturing	GL
Jan-23	Kingpin	Infrastructure	50	Private	Tyre recycling	GL
Jan-23	Stack	Infrastructure	100	Sponsor	Modular nuclear power	GL
Jan-23	Oscar	Infrastructure	40	Private	Environmental services	SLL
Jan-23	Edge	Infrastructure	75	Sponsor	Pipeline	SLL

Source: Company data. Note: *Total deal size for these deals also represents the deal size for the RCP. **GL, green loans; SLL, sustainability-linked loans.

LTM dividend per share implies a 10% yield

RCOI has an 8–10% target annualised yield based on its US$1.00 per share IPO price, with dividends paid quarterly in April, July, October and January. Good cash flow generation across its portfolio allowed it to distribute 9.0 US cents from FY22 profits (including a 1.0 US cent special dividend), which implies a 9% yield on the IPO price (ie at the mid-point of the range) and a c 10% yield on the current share price (given RCOI's c 20% discount to end-2022 NAV, see below). The

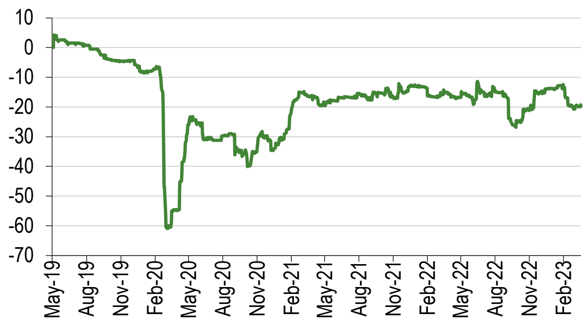
FY22 dividend is well covered by RCOI's FY22 earnings per share of 14.08 US cents, and management highlighted that RCOI's FY22 cash flow covered the dividend by 109%.

RCOI aims to pay 100% of its quarterly income (after payment of expenses) as dividends. However, it can retain up to 15% of its income if the board believes it is in the best long-term interests of the company. We believe that RCOI may decide to retain some of its future income to facilitate organic growth of its NAV.

Discount to NAV at c 20%

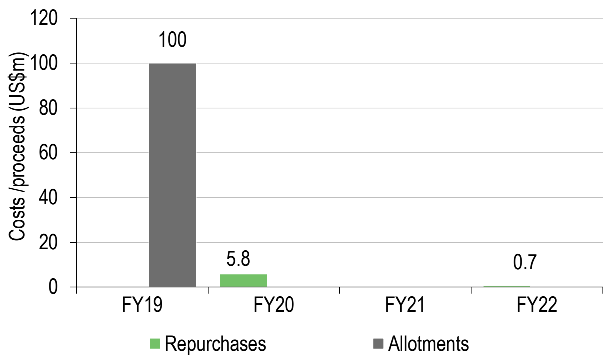
RCOI's shares have been trading at a discount in the teens since early 2021 (after recovering somewhat from the COVID-19 pandemic-induced sell-off). This is despite a relatively benign outlook for the oil and gas industry, the continued solid performance of the portfolio and a good dividend stream. Except for one investment (Caliber Midstream, currently valued at 40.7% of par value), the overall performance across RCOI's portfolio has been good and we again stress the loans are all first-lien and asset-backed and with an average LTV ratio of 40% at end-2022 (and an investment policy limit for LTV of 60% for each investment); therefore they are likely to have good recovery values or to be successfully restructured, possibly with no investment losses to RCOI.

Exhibit 13: Discount since inception (24 May 2019)



Source: Refinitiv, Edison Investment Research

Exhibit 14: Buybacks and issuance



Source: Morningstar, Edison Investment Research

The company can buy up to 14.99% of its shares and did so in 2020 when the discount was even wider. The authorisation has to be renewed annually, usually at the AGM (the next AGM is on 18 May 2023). RCOI repurchased 740.1k shares in 2022 (representing c 0.8% of the shares outstanding on 1 January 2022) for c US$0.65m.

Fund profile: Energy infrastructure credit specialist

RCOI launched in May 2019 and is an England-domiciled, London-listed, closed-end investment company with a focus on credit opportunities in small and mid-sized energy companies. It invests in companies at all stages of energy exploration, production and distribution. To diversify risk and provide synergies, the company aims to invest across different geographies (both in terms of production and end-markets) and in different commodities.

Typically, issuers will be domiciled in the United States (or with the majority of the operations in the United States), but the remit allows for lending to companies in other regions. The loans are also typically delayed draw term loans, with the borrowers paying some interest on the undrawn portion (the weighted average undrawn spread at entry as at end-2022 was 4.0% pa).

While most of RCOI's investing will be direct lending, it will also look at capital relief and market-based opportunities. Capital relief transactions consist of RCOI buying non-conforming energy loans from banks that no longer can or wish to keep them on the balance sheet. Unlike direct lending, due diligence will typically be based on public information and RCOI is unlikely to be able to influence the underlying terms. These investments may also be part of a larger syndicate. Market-based investments will be conducted on the open market and can include bonds as well as syndicated loans. Both capital relief and market-based investments are expected to be secondary to direct lending and only carried out when the expected returns match or exceed the opportunities in direct lending. Since inception to end-2022, RCOI committed US$13.4m in total to capital relief/market-based investments, realising US$13.6m.

Approach to ESG

Although RCOI, as a credit investor, has more limited influence on its portfolio companies compared to equity investors, it does seek to encourage ESG transparency and alignment of its borrowers through board observer seats, ESG questionnaires and scorecards, as well as affirmative covenants and loan economics tied to sustainability metrics. RCOI’s manager is currently collaborating with third-party partners to develop an ESG onboarding deck for borrowers (to help them achieve Riverstone’s nine ESG minimum expectations over time) and to assist in ESG monitoring and assessment throughout the life of the loan. These partners will also help RCOI’s manager to drive its diversity and inclusion initiatives. In this context, we note that one of RCOI’s three independent directors is female.

Given that all RCOI’s investments are now structured as sustainability-linked or green loans, they contribute to advancing decarbonisation and energy transition infrastructure. RCOI’s manager highlighted that it has so far committed an aggregate c US$880m (across all its managed vehicles) towards investments in decarbonisation and the transition to a low carbon economy (with more than US$825m structured as green and sustainability-linked loans). When evaluating a new investment opportunity, RCOI’s manager starts by assessing whether it meets the Green Loan Principles developed by the LSTA with respect to: (1) use of proceeds, (2) process for project evaluation and selection, (3) management of proceeds, and (4) reporting. If the opportunity does not qualify as a green loan, RCOI’s manager will evaluate the sustainability goals of the company and loan structure based on LSTA’s Sustainability Linked Loan Principles. Key considerations are: (1) The sustainable performance targets need to be set by the company and not the lender, (2) the sustainability goals are measurable and auditable, and (3) negative economic consequences are imbedded in the loan documentation for failing to meet the goals by a specified timeline. Furthermore, RCOI’s investment manager will obtain a second-party opinion from Sustainable Fitch.

RCOI’s investment manager highlighted that it had made progress in its ESG reporting, resulting in partial alignment with the recommendations of the Task Force on Climate-Related Financial Disclosures (even though RCOI is exempt from TCFD disclosure requirements as an investment trust). It also engaged Persefoni (a carbon accounting firm) to collaborate with its borrowers to develop high-quality greenhouse gas inventories to track their emissions. This is aimed at providing disclosure of Riverstone-financed emissions, including scope 1 and scope 2 emissions generated by its portfolio companies. RCOI’s manager also performed climate risk assessments to identify physical and transition risks for the majority of its portfolio. Riverstone is a signatory to the UN Principles for Responsible Investment.

Investment process

Please see our initiation note, Niche energy infrastructure lending, published on 11 March 2021, for a full description of the investment process.

Gearing: US$15m RCF secured by the SPVs

In December 2022, RCOI's SPVs entered into a US$15m RCF to optimise their investment level while at the same time providing liquidity for future obligations such as undrawn investment commitments (which at end-2022 stood at c US$8m) and ongoing expenses. The RCF is subject to an interest rate at SOFR + 650bp on drawn amounts (subject to a 1% SOFR floor). At end-2022, US$5m of the RCF was drawn by the SPVs, translating into a minor 5.2% gross gearing of the fair value of underlying investments.

RCOI itself had no borrowings at the end of FY22. As set out in its memorandum of association, RCOI is permitted to borrow up to 30% of its gross assets, at the time of borrowing. This limit excludes non-recourse financing in any special investment vehicles such as the non-recourse loans in its two Delaware-based limited partnerships (Riverstone International Credit and Riverstone International Credit-Direct).

Fees and charges: No management fee charged

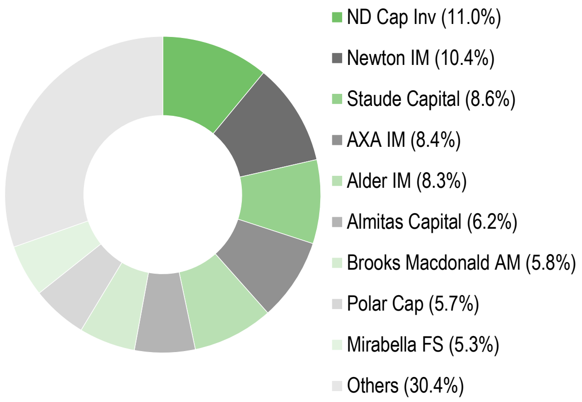
There is no base management fee paid by RCOI to the investment managers or to any Riverstone group entity. We believe this is an attraction that helps aligns the interests of shareholders with management. The remuneration for management will be solely through a profit share. On top of this, RCOI only pays for reasonable reimbursable expenses as well as directors' fees.

The incentive system is three tiered. It is paid quarterly but reconciled on an annual basis. There is no catch-up/adjustment on profit share beyond the fiscal year. Payment is 0% up to an annual distributable income of 4%, 20% is paid out of income between 4% and 8%, and 30% out of the distributable income greater than 8%.

Capital structure

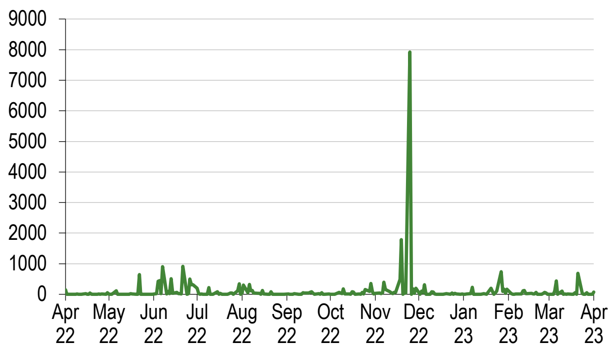
RCOI has a single share class, with 90.8m ordinary shares in issue. There are no rules restricting the directors' ability to issue additional shares on a non-pre-emptive basis at any time. The directors may issue additional shares, pursuant to a placing programme or otherwise, if they determine this to be in the best interests of shareholders and Riverstone as a whole. No shares have been allotted since RCOI's IPO in May 2019, when it raised c US$100m in proceeds through issuing 100m ordinary shares at US$1.00 per share, and all of its 100m ordinary shares were admitted to trading on the Specialist Fund Segment of the London Stock Exchange.

Exhibit 15: Major shareholders (31 March 2023)



Source: Refinitiv

Exhibit 16: Average daily volume ($000s)



Source: Refinitiv

The board

RCOI's board is comprised of three non-executive directors, all of them independent of the investment manager.

Chairman Reuben Jeffery III has a broad range of financial services experience, particularly in investment banking, and brings extensive insight into the US political and regulatory environment. He is chairman of Sumitomo Mitsui Banking Corporation Americas Holdings and is a former non-executive director of Barclays. He was previously President and CEO of Rockefeller Financial Services and served in the United States government as undersecretary of state for economic, energy and agricultural affairs between 2007 and 2009. He also served as chairman of the Commodity Futures Trading Commission and as a special assistant to the president on the staff of the National Security Council. Before his government service, he spent 18 years at Goldman, Sachs & Co where he was managing partner of Goldman Sachs in Paris and led the firm's European Financial Institutions Group in London. Before joining Goldman Sachs, he was a corporate attorney with Davis Polk & Wardwell.

Emma Davies is co-CEO of Octopus Ventures and a non-executive director of Baillie Gifford European Growth Trust. She was head of direct investments at Marylebone Partners, an independent wealth management firm. She was previously also head of property and infrastructure at the Wellcome Trust, where she also helped to manage the public markets portfolio. She was formerly CIO of Big Society Capital and ran the European investments team for Perry Capital.

Edward Cumming-Bruce is the vice-chairman of Gleacher Shacklock, which he joined in August 2003. Prior to that he worked for 12 years at Dresdner Kleinwort Wasserstein, where he held a number of senior positions including co-head of global telecoms investment banking, co-head of UK investment banking and global head of equity capital markets. Mr Cumming-Bruce has extensive experience advising a range of major European companies on capital markets and restructuring transactions as well as mergers and acquisitions. Before Dresdner Kleinwort Wasserstein, he worked at Schroders.

Exhibit 17: RCOI's board of directors

Board member	Date of appointment	Remuneration in FY22	Shareholdings end-FY22
Reuben Jeffery III (chairman)	2 April 2019	US$55,400	100,000
Emma Davies (audit and risk committee chair)	2 April 2019	US$49,245	45,000
Edward Cumming-Bruce (nomination comm. chair)	2 April 2019	US$43,089	50,000

Source: Riverstone

EDISON

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