PREFERRED STOCK IN THE SHIPPING SECTOR

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There has been an increasing trend for private equity investments in the shipping sector to take the form of preferred stock in either publicly listed or private companies, rather than through a more traditional method of establishing a joint venture with an established shipowner. Broadly speaking, preferred stock is stock that has whatever features are determined by the company, although typically the stock offers its holders priority dividend and liquidation rights over common equity holders – often with additional features built-in by the parties.

The issuance of preferred stock by a company provides potential benefits for both the investor and the managing shipowner. It also allows both parties to execute the investment relatively quickly. In an industry where the market can change on a weekly basis and opportunities may be short-lived, those who can raise and deploy capital quickly are at a distinct advantage. The negotiation of an operating or shareholders' agreement for a traditional joint venture is generally a drawn-out affair – especially for parties who do not have a history of working together. A preferred stock issuance of this type would usually take the form of "blank check" preferred stock, which can be issued by a company's board of directors, without necessarily having to involve its existing shareholders. While some preferred stock deals are bespoke and heavily negotiated, there are some preferred stock deals that use more standardized terms and formulations, and therefore are quicker and more straightforward to implement.

Preferred stock can be tailored to the investment criteria of the shipowner and outside investor, allowing for flexibility in terms. Although the investment may be in the form of equity, it can be debt-like, with cumulative dividends, limited voting rights, and sometimes convertibility into common stock at the discretion of one or both of the parties. Additionally, contrary to common perception, preferred stock can be issued at the SPV level – it does not have to be issued at the public (holding) company level – which further allows for the segregation of a specific asset or group of assets. Like traditional debt financing, this allows the shipowner to ring-fence a particular vessel or series of vessels, much like traditional non-recourse debt where one or more ship-owning special purpose vehicles act as borrowers.

Preferred stock can be structured in a range of ways and have features to meet the needs of the parties, including any one or more of the following:

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- fixed dividend payments based on a percentage of the purchase price or liquidation preference of the preferred stock;
- floating dividend payments based on a benchmark interest rate index or percentage of a company's earnings;
- the deferral of dividends or dividends that are paid in additional stock, which unlike debt interest payments, allow an issuer to conserve cash in the case of financial difficulty without defaulting;
- cumulative dividends, which if not paid, accumulate in successive periods;
- non-cumulative dividends, which if not paid, are not required to be paid in successive periods;
- remedies for the non-payment of dividends, such as their accrual as payment-in-kind of additional preferred shares, increased voting rights, or right to appoint directors to the board of the issuer;
- either limited or no voting rights, which allow for an issuer to raise equity capital without ceding control of the company, or the preferred stock can have full voting rights or some reduced voting ability;
- special voting rights, which allow for a preferred stockholder to vote only in special circumstances, such as the issuance of additional shares of a similar or superior class of stock, the appointment of a certain number of directors, or approving a key acquisition or material transaction;
- liquidation preference, which allows for preferred stockholders, in the case of liquidation, to recoup their investment and accrued and unpaid dividends prior to any common stockholders, but after any debt holders;
- convertibility to common stock – either mandatory or optional by the company or the shareholder, whether on or after a specific date or at any time, or after a specified event occurs, and the formula for conversion;
- a call option, or the redemption of the preferred stock at the option of the issuer, at a predetermined price or formula; and
- a put option, or the sale of the preferred stock at the option of the holder, at a predetermined price or formula, whether after a specific date or occurrence of a specific event.

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Examples of preferred stock issuances over the past few years (or, in the case of master limited partnerships, preferred units) include those of Altera Infrastructure L.P., Dynagas LNG Partners LP, KNOT Offshore Partners LP, Euroseas, Ltd., Tsakos Energy Navigation Ltd. and Costamare Inc.

The flexibility of preferred stock – which can be tailored in nearly any conceivable way – makes it a key feature in a sophisticated shipping company's capital structure, while being subordinated to debt. In addition, if preferred stock is convertible into common stock that is already trading on a stock exchange, an investor's exit may be easier than in a traditional joint venture.

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As outside investors are often unfamiliar with the shipping industry, retaining advisors who are experienced in the maritime industry is key to a successful investment in the sector. Watson Farley & Williams is experienced in such transactions – representing shipowners and investors in preferred stock deals – and can provide a uniquely comprehensive perspective of the industry.

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