Seaspan Preferred Shares: 7.8% Yield, Worth Considering

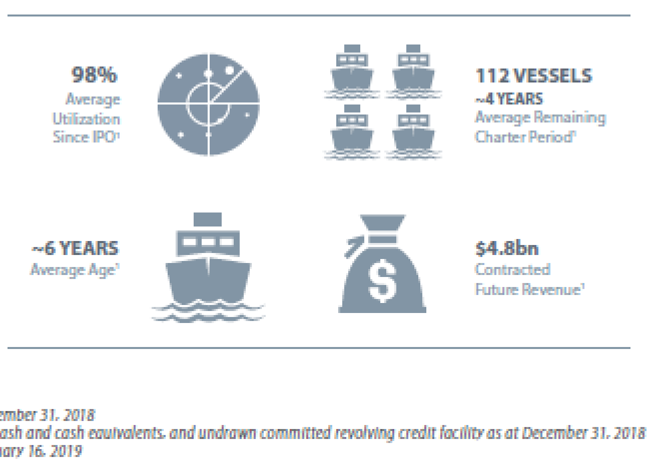
Key Takeaways:

- Simultaneous increase in scale and efficiency.
- Long term revenue contracts with industry leaders leading to stable cash flows.
- Industry first financing program for cheaper, more flexible credit.

If it's steady high-income you're looking for, Seaspan's series I preferred shares (SSW.PI) are worth considering. You shouldn't expect any price appreciation for these shares (they'll continue to hover right around $25), but the big quarterly dividend payments are supported by a strong growing business (Seaspan's fleet has grown dramatically while simultaneously increasing operational efficiency), strong financials (access to cash on favorable terms) and favorable industry dynamics (demand for Seaspan's differentiated fleet). Further, the 7.8% dividend yield will go a lot farther than most other income investments, and it'll do so with considerably less volatility risk and stress.

Overview:

Seaspan Corporation (SSW) is a leading independent charter owner and operator of containerships with industry leading ship management services. The company leases its fleet to some of the world's largest liner companies. Between 2005 to today, SSW has increased its fleet size from 10 to 112 and has a total capacity of more than 900,000 Twenty-foot Equivalent Unit ("TEU"). The incredible increase in capacity has been met with high asset utilization and consistent growth. The company's fleet has an average age of ~six years and the average remaining lease period is over four years, on a TEU-weighted basis. Responding to industry demand, SSW launched the 10,000 and 14,000 TEU SAVER vessel series that incorporate the latest technological and environmental advancements while maintaining its commitment to quality. This has positioned SSW well to generate strong, stable and visible cash flows across shipping cycles[1].



[1] SSW_Annual Report _2018

Why Series I?

We like the Series I shares. They offer an 8.00% dividend yield (based on $25 per share) and they're callable starting October 31, 2023. Dividends are payable quarterly (2.00%) and as is common with preferred stock, it is currently trading close to its par value at $25.60 (face value: $25.00) thereby offering a yield of 7.8%. The stock has a fixed-to-floating structure wherein it pays a fixed dividend of 8.00% until October 2023 and then perpetually pays a dividend of LIBOR+5.008% until it is called. While preferred stock is prioritized over common stock in the capital structure it is still second to the company's debt[2].

Seaspan Corporation 8.000% Perpetual 25.600 Corporate Preferred Stock

Security Information

Cusip	Y75638141
ISIN	MHY756381411
SEDOL	BGK2289
Primary Exchange ID	SSW.PRI-USA
Underwriters	Multiple
Country of Domicile	Hong Kong
Country of Risk	Hong Kong

Issue Status

Offering Date	12-Sep-2018
Issue Date	19-Sep-2018
Maturity Date	Perpetual
Security Type	Corporate Preferred Stock
Preferred Type	Preferred Equity
Seniority Level	Junior Preferred
Issue Currency	U.S. Dollar
Pricing Sources	NYSE (SSW.PRI-USA)
Financial Covenants	No

Issue Size

Original Issue Par Value (USD)	150,000,000
Original Shares Issued	6,000,000.00
Current Amt. Outstanding Par Value (USD	-
Current Shares Outstanding as of 30 Jun '1	-
Maturity Price (% of Par)	Perpetual
Offering Price (% of Par)	100.00
Face Value	25.00
Minimum Denomination	25.00
Minimum Increment	25

Issuer & Industry

Immediate Issuer	Seaspan Corporation
Credit Parent	Seaspan Corporation
Ultimate Parent	Seaspan Corporation (SSW-US)
FactSet Industry	Marine Shipping
SIC Sector	Water Transportation Services, Not Elsewhere Classified
NAICS Sector	Commercial Air, Rail, and Water Transportation Equipment Rental & Leasing

Dividend Details

Dividend Rate (% of Pa	8.000
Divdend Pay Type	Combo - Fixed/Floating
Payment Frequency	Quarterly
Day Count Basis	30/360
Dated Date	19-Sep-2018
First Dividend Date	30-Oct-2018
Next Dividend Date	30-Oct-2019
Last Dividend Date*	30-Jul-2069

Redemption Options

Convertible	No
Callable	30-Oct-2023 / 100.00
Putable	No
Sinking Fund	No
Tender/Exchange	No
Conditional Redemptic	No
Redemption	Yes

Ratings

S&P RATING	--
MOODY'S RATING	--

For reference, SSW has four other series of preferred shares outstanding, as summarized in the following table. We like Series I because it offers a high relative yield (fixed and floating) on the most long-term basis (other series are callable sooner). For example, series C and D are past their fixed return stage and/or can be called at anytime. And Series G and H are callable earlier than Series I while offering a very similar yield. Given the company's strong operational metrics and favorable industrial environment, we believe Seaspan has the ability to easily pay dividends well past 2023, thereby making Series I attractive[3].

[2] Factset

[3] Factset

Name	Redeemable from	Dividend Frequency	Par Value	Coupon Yield	Current Price	Current Yield
Series D	30/01/2018	Quarterly	$25.00	7.95%	$25.25	7.87%
Series E	13/02/2019	Quarterly	$25.00	8.25%	$25.58	8.06%
Series G	16/06/2021	Quarterly	$25.00	8.20%	$25.58	8.01%
Series H	11/08/2021	Quarterly	$25.00	7.88%	$25.33	7.77%
Series I	30/10/2023	Quarterly	$25.00	8.00%	$25.60	7.81%

High operational efficiency

Over the past five years, SSW has considerably improved its operational efficiency. To begin with, between 2014 and 2018, the average utilization level for the company's fleet has been >97% (98.7% as of Q2 2019), even as the fleet size has increased by an impressive 45.5%. The company has also seen a reduction in idle days where June 2019 became the first month in the last 2 years with no off-charter days.

As of Q2 2019, LTM revenue reached its highest level over the last five years, while SSW's operating cost per ownership day declined to $5,743, the lowest in the last five years. Additionally on the employee front, the company has seen a reduction in frequency of injuries that result in downtime while also improving seafarer retention to 96%[4].

US$ Millions, except operating data and per share amounts

Key Performance Metrics	For the year ended December 31 2014	2015	2016	2017	2018
Ownership Days	25,408	28,133	30,593	32,007	37,264
Operating Days	25,157	27,717	29,384	30,630	36,458
Operating Cost per Ownership Day	6,537	6,890	6,287	5,746	5,884
Vessel Utilization	99.0%	98.5%	96.0%	95.7%	97.8%

Secured revenue and visible cash flows

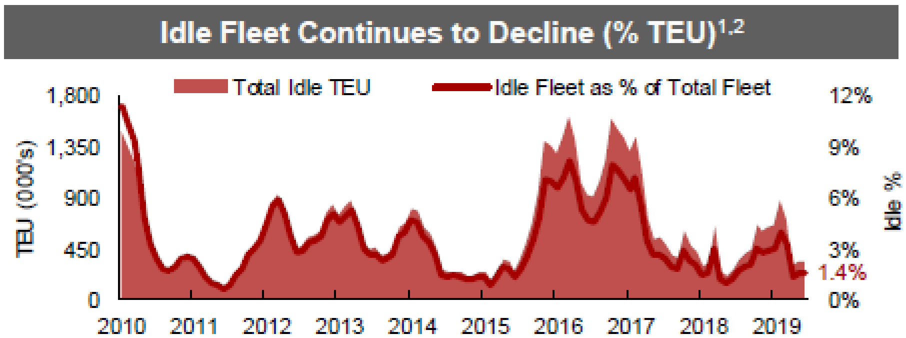
SSW operates through time-charters wherein the charterer hires the vessel and pays a daily rate (charter rate) to SSW. The company's strategy of signing long-term contracts in tandem with its shipbuilding contracts has resulted in stability in long-term revenue while also ensuring high asset utilization. Some of its customers include a few of the biggest shipping companies globally such as COSCO, MSC, Maersk Line and CMA. For reference, COSCO and MSC (which combined account for 37% of total revenues) have fixed-rate contracts for periods as long as 12 and 17 years respectively.

As of Q4 2018, SSW had ~$4.8 billion in total remaining contracted revenues primarily locked into long-term, fixed-rate charters with strong credit counterparties and an average remaining charter life of over four years. This, combined with decrease in operating costs, is expected to secure margins in the coming years.

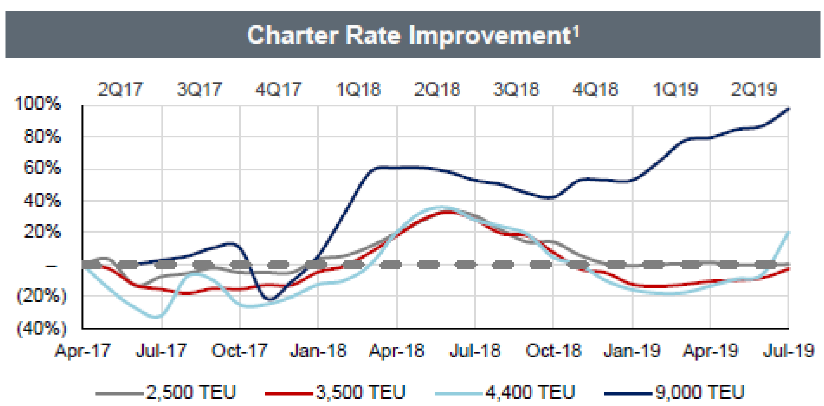
[4] SSW Annual Report 2018

Favorable industry dynamics

There are several indicators that fundamentals in the container shipping industry are strong and will continue to support charter rates in the long run. The industry's supply rationalization and overall demand improvement has driven idle fleet reduction to the extent where in 2019, the idle fleet accounts for only 1.4% of the total global fleet[5].



As seen in the chart below[6], since Q2 2017, there has been a continuous increase in charter rates for larger vessels due to a limited number of deliveries scheduled for 2019 combined with continued restraint on newbuild ordering. This is a massive benefit for SSW as the company had shifted its focus to high capacity energy efficient vessels staring in 2011. As of Q2 2019, ~70% of the company's fleet comprised of vessels over 10,000 TEU in size.

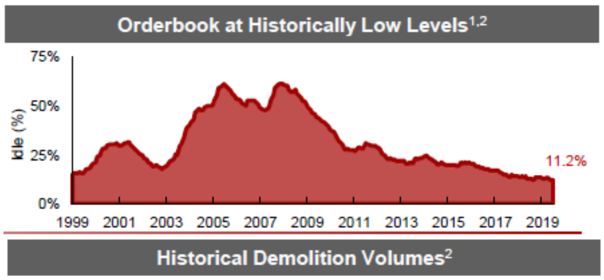


The current orderbook-to-fleet ratio is 11.2%, the lowest level in the last 20 years. The order book continues to be polarized with ~70% of the order book in terms of vessel numbers being below 3,000 TEU and ~40% of the order book in terms of TEU being larger than 15,000 TEU in size. This implies that there is not much scope of increase in competition for SSW since very few larger

[5] SSW Presentation Q2 2019
[6] SSW Presentation Q2 2019

vessels are being built and delivered while the demand remains high[7]. Quoting Executive Vice President Peter Curtis in the Q2 2019 earnings call,

"The lower order book demonstrates both an increase in ordering discipline as well as limited resources for the ordering of new vessels, which we see as positive developments for Seaspan as we were able to take advantages of our size, scale and financial strength."



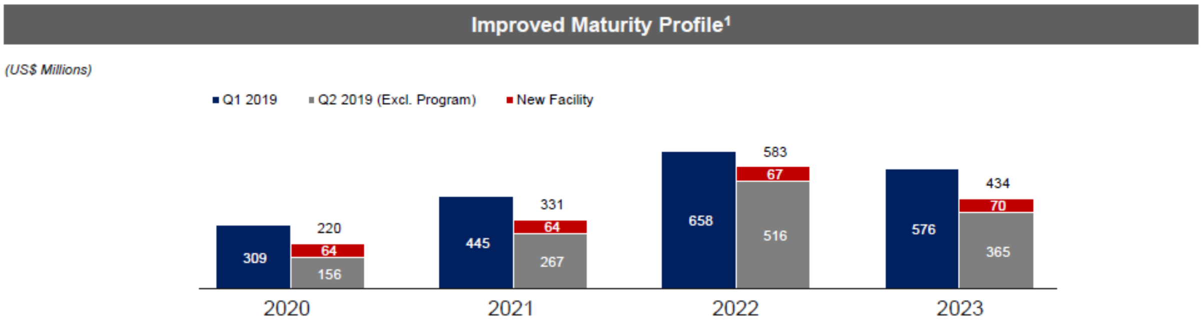
Industry-first financing program

In May 2019, SSW closed its inaugural $1.0 billion Vessel Portfolio Financing Program with a syndicate of lenders for a secured credit facility. In addition to improving the cost of capital through improved interest rates, the program greatly enhances the company's flexibility to manage liabilities. The financing structure has been designed to be flexible and controlled by a borrowing base which allows for SSW to draw or repay debt and add or remove secured assets. With this facility in place, the company's pool of unencumbered assets becomes more liquid and valuable from a flexibility standpoint.

The program has also helped improve the company's maturity profile[8]. SSW used the proceeds from this facility to prepay a significant portion of its outstanding debt over the next four years, especially debt due in the next couple of years. This has reduced debt repayment burden on the company's cash flow, leaving even more cash to be distributed as dividends; ideal for income-focused investors. Quoting the President and CEO Bing Chen on the Q2 2019 earnings call,

"As previously mentioned in our closing call, we closed our $1 billion portfolio financing program, which will be our primary source of secured financing going forward. We have continued to execute on our capital strategy, repaying the remaining $311.4 million outstanding on our 2019 notes in April and subsequent to the quarter-end have prepaid $231.3 million of the secured debt, increasing our pool of unencumbered assets to 40 vessels."

[7] SSW Presentation Q2 2019
[8] SSW Presentation Q2 2019



The structure of this program is an industry first and the borrowings are expected to be the primary source of secured financing for the company going forward. In September 2019, the company closed an additional $500.0 million increase under this program, upping the total capacity to $1.5 billion.

Backed by strong stakeholders

In 2018, Fairfax Holdings ("Fairfax") under Prem Watsa's proven leadership announced a two-tranche investment of $1.0 billion in SSW, split equally between debentures and warrants. This made Fairfax the largest shareholder in SSW with a 36% stake, while also making SSW Fairfax's largest holding. Having Prem Watsa, who has been called the Canadian "Warren Buffet" make such a huge investment in SSW reinforces our confidence in the company's prospects.

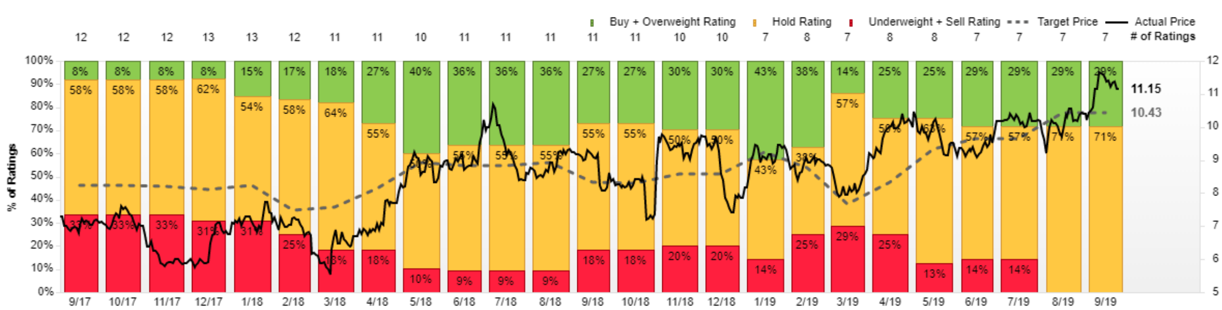
Fairfax's investment has strengthened the SSW's balance sheet, reducing the company's debt to equity ratio significantly. Additionally, in the capital intensive industry that SSW operates, access to capital is a major driving force in the company's long-term ability to generate value. Having Fairfax's backing will allow SSW to execute on opportunities at times even when competitors are starved for liquidity.

Valuation:

The below table summarizes the company's valuation metrics in comparison to the industry average[9].

	5 Year				
Valuation Multiple	Current	High	Low	Avg	Vs Ind
P/E (LTM)	5.6x	25.2x	4.0x	12.4x	0.3x
P/E (NTM)	14.3x	18.9x	5.5x	11.1x	1.1x
PEG (NTM)	-	3.0x	0.3x	0.9x	-
P/B	0.8x	1.3x	0.3x	0.7x	1.0x
P/CFO	3.0x	6.6x	1.6x	4.0x	0.5x
P/Sales	2.1x	3.1x	0.6x	1.6x	1.5x
EV/EBITDA	8.0x	13.0x	8.0x	9.7x	0.8x
EV/Sales	5.6x	8.5x	5.1x	6.4x	1.5x
Div Yld	4.5%	29.9%	4.3%	10.0%	1.1%

As you can see in the chart below, the majority of the brokers following SSW have given the common stock a 'buy' or 'hold' rating, which indicates their confidence in the company's prospects[10].

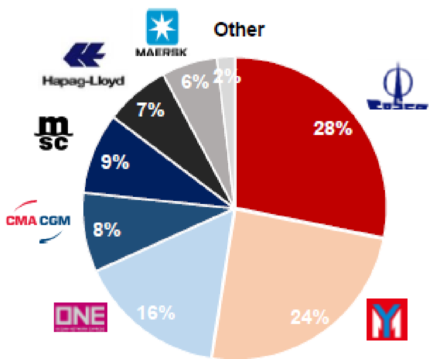


Risks:

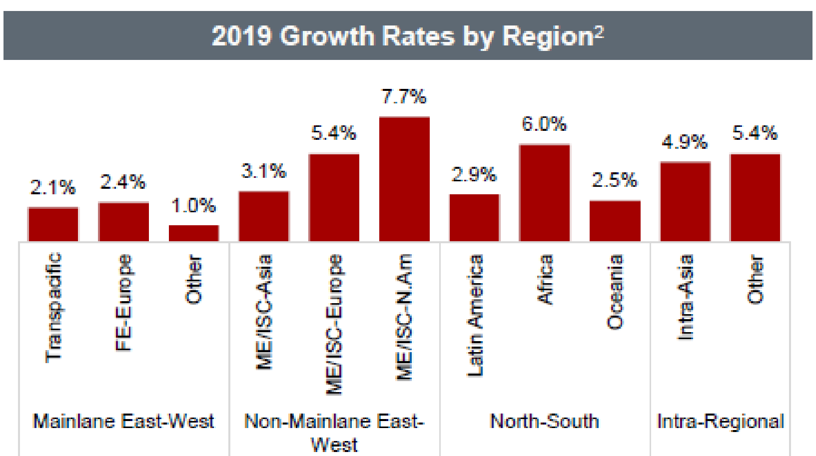
One of the risks associated with SSW is its high customer concentration where the top seven customers make up ~98% of the company's revenues with just two of these, COSCO and Yang Ming (YM), accounting for more than 50%. If any of these companies were in a distressed situation, it would significantly impact SSW's revenue stream. However, it is noteworthy that these seven companies are among the ten biggest shipping companies globally. The gigantic scale of these companies makes them very reliable customers. COSCO, the largest contributor

[9] Factset
[10] Factset

to revenue with a 28% share, is a Chinese state-owned enterprise which highlights the financial strength of SSW's customers[11].



Important to note, the current US-China trade war could potentially have an adverse impact on the demand for SSW's vessels. However while addressing the situation, President and CEO Bing Chen clarified that the war would primarily impact transpacific routes and for a shipping company as big as SSW, the solution was as simple as changing routes. He estimates an overall negative impact of 2% on the industry, which would be easily offset by higher growth that the company is experiencing within other routes[12].



[11] SSW Presentation Q2 2019

[12] SSW Presentation Q2 2019

Conclusion:

Seaspan's 8.00% yield, Series I, preferred shares are attractive. The company has done an outstanding job scaling up its operations while simultaneously maintaining a high asset utilization rate. And the nature of its fixed-rate long-term contracts (with shipping industry leaders) is expected to deliver stable revenues for years to come. Also impressive, the company's high operational efficiency helps to ensures the stability of its cash flows. Further still, the company's new $1.5 billion financing program is an industry first, providing Seaspan with a flexible borrowing base structure and allowing the company to finance vessels on a short-term basis. If you're looking for a steady big dividend, Seaspan preferred shares are absolutely worth considering for a spot in your prudently diversified, long-term, income-focus investment portfolio.