

Private Equity in Shipping

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- Introduction
- Speakers:
 - Gary Wolfe
 - Robert Van Grover
 - Craig Sklar
 - Jim Cofer
 - Arthur Kozyra

Private Equity in Shipping

- Cyclical nature of shipping business
- Decline in vessel values
 - Private equity investors' investment opportunities
- Dearth of traditional bank financing
 - Shipowners' alternative financing sources

What are the types of private equity shipping investments?

- Direct Shipping Investments
- Shipping Private Equity Funds
- Shipping Private Equity Ventures (SPEVs)

SPEVs: What's in the name?

- **SPEVs: Shipping Private Equity Ventures**

a joint venture between a vessel operator and one or more private equity investors with private equity fund-like features

- **Private Fund Elements**

- Closed-end investment
- Long term investment
- No periodic redemptions
- Waterfall/carried interest

- **Joint Venture Elements**

- Joint management
- Contribution of capital
- Contribution of services

What are key considerations for SPEVs?

- Purpose
- Form of entity and jurisdiction (*tax considerations*)
- Economic terms
- Governance issues
- Conflicts of interest (*vessel opportunities*); Non-competition/non-solicitation (*exclusivity*)
- Key person; Management issues
- Liability and indemnity limitations
- Limitations on transfers; Exit strategy
- Deadlock events and dispute resolution mechanisms

What are the key economic terms?

- Ownership and size of each party's capital commitment
- Procedures for capital calls and remedies for default
- Length of the investment period
- Distribution waterfall
- Vessel operator compensation (*carried interest, commercial and technical vessel management fees*)
- Monitoring; transaction fees (*PE Investor and Vessel operator*)

SPEVs: Comparison

	<u>SPEV 1</u>	<u>SPEV 2</u>	<u>SPEV 3</u>
Ownership:	PE Investor: 85% Vessel operator: 15%	2 PE Investors: 90% Vessel operator: 10%	3 PE Investors: 95% Vessel operator: 5%
Investment Period:	2 years	3 years 2 years (if less than 4 vessels acquired) 1 year (if less than \$50 million invested)	18 months
Governance:	4 Board members: 3-PE Investor 1-Vessel operator	5 Board members: 4-PE Investor 1-Vessel operator	7 Board members: 6-PE Investor 1-Vessel operator

SPEVs: Comparison (cont.)

	<u>SPEV 1</u>	<u>SPEV 2</u>	<u>SPEV 3</u>
Distributions waterfall:	-Return of capital -90/10 until 2x capital -85/15 until 2.5x capital -82.5/17.5 until 3x capital -80/20 <i>Vesting of carried interest over a 3 year period</i>	-Return of capital -8% IRR -85/15 until 25% IRR and 3x capital -80/20 <i>Vesting of carried interest over a 4 year period</i>	-Return of capital -Greater of 8% IRR or 1.4x capital -85/15 until 16% IRR and 2x capital -80/20 until 25% IRR and 2.5x capital -70/30 <i>Vesting of carried interest over a 5 year period</i>

SPEVs: Comparison (cont.)

	<u>SPEV 1</u>	<u>SPEV 2</u>	<u>SPEV 3</u>
Vessel operator compensation:	Industry standard vessel commercial and technical management compensation	Industry standard vessel commercial and technical management compensation Additional compensation based on no. of vessels (~\$300K)	Industry standard vessel commercial and technical management compensation Additional compensation based on enterprise value (~\$500K)
Monitoring; Transaction fees:	NA	Annual monitoring fee equal to the greater of: 0.1% of each investors capital or pro rata share of 1% EBITDA	Annual monitoring fee equal to 1% EBITDA Transaction fee equal to 1% of total enterprise value of each investment

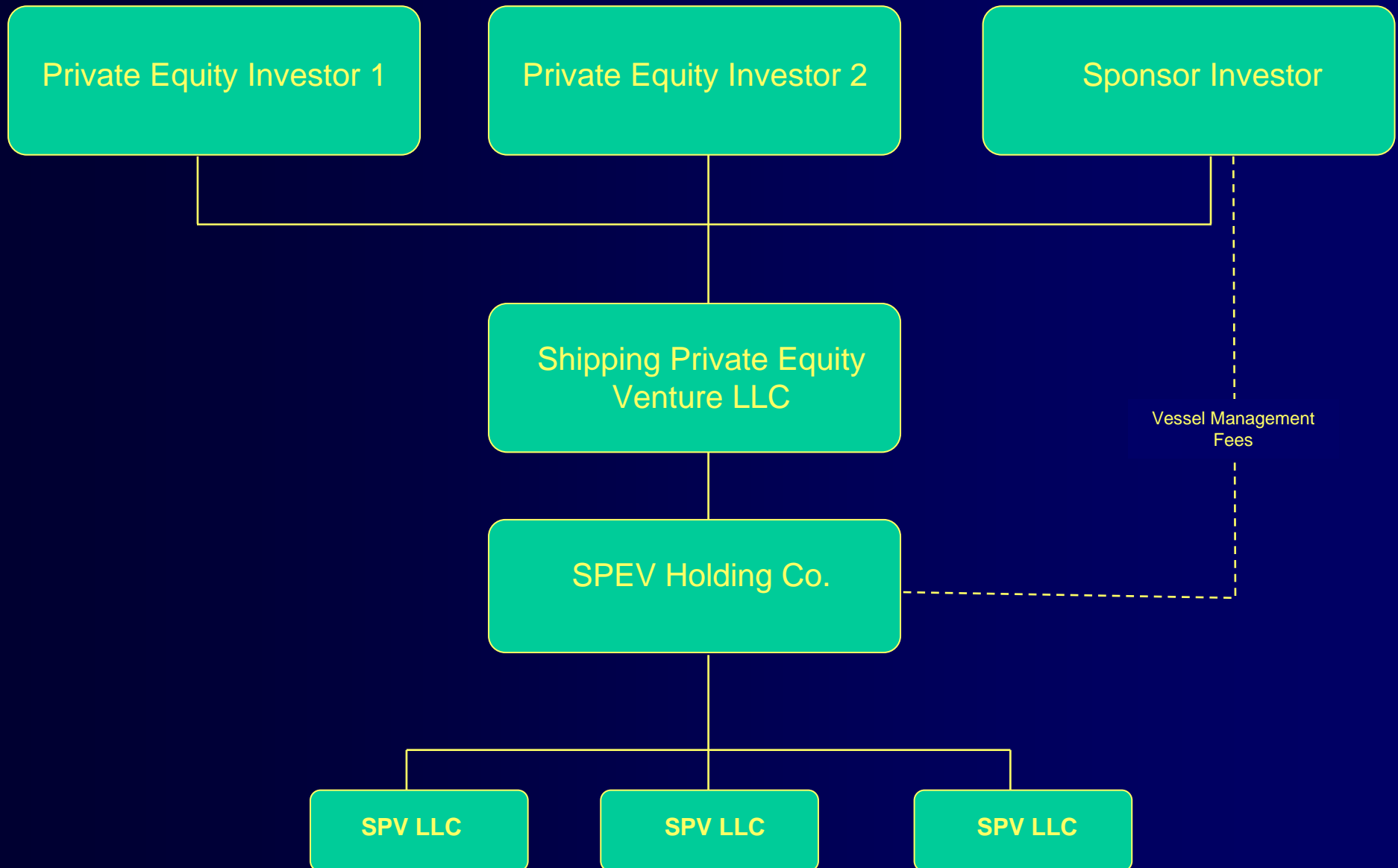
What is the preferred form of entity and jurisdiction?

- SPEVs can take the form of:
 - Corporation
 - Partnership
 - Limited liability company
- Vehicle of choice: a Marshall Islands limited liability company
 - Simplicity
 - Flexibility
 - Well-developed body of jurisprudence
 - Marshall Islands Limited Liability Company Act based on Delaware Limited Liability Company Act
 - Article 71: Non-statutory Delaware law adopted as MI law
 - U.S. tax classification

What are the tax considerations?

- U.S. tax classification
- Controlled Foreign Corporation (CFC)
- Passive Foreign Investment Company (PFIC)
- U.S. taxation of shipping income (Sections 883/887)
- Taxation upon exit

What is the typical SPEV structure?



What are the different types of SPEVs investments?

- Direct ownership of a vessel
- Partial ownership of a vessel-owning company
- Debt and alternative financings of shipping companies; sale-leasebacks
- Time or bareboat charters
- Purchase of loans secured by vessel mortgages
- Acquire interest in a publicly traded shipping company

What? Need to register with the U.S. Securities and Exchange Commission?

- SEC registration requirement
- Investing in “securities” v. operating shipping companies
- Compliance program
 - Carried interest
 - Investment allocation
 - Side letters
 - Performance advertising
 - Code of ethics
 - Custody of assets
 - Political contributions
 - Recordkeeping; e-mail retention

Q&A Session

Thank you