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Tsakos Energy Navigation: Sticking With The 10% Yielding Preferreds

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Summary

- The oil shipping business has performed poorly in 2021, but it looks like the situation is starting to look better.
- I'm not interested in the Tsakos common shares, but I think the preferred shares offer an attractive risk/reward profile.
- The preferred dividends are currently not covered by the earnings, but an uptick in the charter rates will help to improve the coverage ratio.

Tony Cane-Honeysett/iStock via Getty Images

Introduction

I have been building up my exposure to oil shipping companies and Tsakos Energy Navigation (TNP) is one of the logical contenders to look at. While I'm not too keen on the company's common shares, I will explain why I think the preferred shares are offering a decent enough risk/reward profile for my portfolio, and why I have been slowly adding them.

Data by YCharts

The Q3 results were rather poor, but Suezmax and Aframax charter rates are on the rise

Investors tend to have a backward-looking perspective and that's usually not great as the past is likely already incorporated in the share price. Forward-looking perspectives are what really matter, especially in a cyclical business like shipping.

I won't waste too much time on the company's financial results as those results were bad, and that was generally to be expected. I will however briefly discuss them before moving over to why I think the oil shipping business may do much better in the next 2-3 years.

During the third quarter, Tsakos generated a total revenue of just under $132M, resulting in an operating loss of $16.3M. Additionally, there was a total financing cost of around $8M resulting in a net loss of approximately $25M. On top of that, we still have to deduct the preferred share dividends to the tune of almost $8.6M, resulting in a net loss of $34M attributable to the common shareholders of Tsakos Energy Navigation. Considering the weighted average share count was just under 20M shares, the net loss was roughly $1.72 per share and this confirmed the trend in 2021 as the YTD net loss attributable to the shareholders of Tsakos Energy Navigation was approximately $77M, of which about a third was directly caused by the preferred stock dividends.

STATEMENT OF OPERATIONS DATA	Three months ended September 30 (unaudited) 2021	2020	Nine months ended September 30 (unaudited) 2021	2020
Voyage revenues	$ 131,562	$ 142,834	$ 406,991	$ 512,503
Voyage expenses	54,113	37,242	148,979	105,363
Charter hire expense	8,806	5,471	21,250	16,033
Vessel operating expenses	41,158	45,246	128,810	133,440
Depreciation and amortization	36,356	33,144	107,207	102,477
General and administrative expenses	7,464	6,591	21,935	21,859
Loss on sale of vessels	-	-	5,817	3,050
Impairment charges	-	-	-	13,450
Total expenses	147,897	127,694	433,998	395,672
Operating income (loss)	(16,335)	15,140	(27,007)	116,831
Interest and finance costs, net	(8,189)	(13,485)	(22,757)	(60,958)
Interest income	175	28	502	538
Other, net	110	(140)	(83)	377
Total other expenses, net	(7,904)	(13,597)	(22,338)	(60,043)
Net income (loss)	**(24,239)**	**1,543**	**(49,345)**	**56,788**
Less: Net income attributable to the noncontrolling interest	(769)	(123)	(150)	(2,668)
Net income (loss) attributable to Tsakos Energy Navigation Limited	**$ (25,008)**	**$ 1,420**	**$ (49,495)**	**$ 54,120**
Effect of preferred dividends	(8,555)	(9,204)	(24,934)	(28,268)
Undistributed income to Series G participants	-	-	-	(1,370)
Deemed dividend on Series C preferred shares	-	(2,493)	-	(2,493)
Deemed dividend on partially redeemed Series G convertible preferred shares	(457)	-	(2,170)	-
Net income (loss) attributable to common stockholders of Tsakos Energy Navigation Limited, basic	**$ (34,020)**	**$ (10,277)**	**$ (76,599)**	**$ 21,989**
Net income (loss) attributable to common stockholders of Tsakos Energy Navigation Limited, diluted	**$ (34,020)**	**$ (10,277)**	**$ (76,599)**	**$ 24,013**
Earnings (Loss) per share, basic	$ (1.72)	$ (0.55)	$ (4.05)	$ 1.16
Earnings (Loss) per share, diluted	$ (1.72)	$ (0.55)	$ (4.05)	$ 1.16

Source: Financial results Q3

Even if we would add back the depreciation expenses and assuming there was a zero capex during the third quarter, Tsakos would barely make enough money to break even on the cash flow front.

And of course, we cannot assume the capex will be zero as Tsakos is expecting the delivery of a new LNG vessel in January 2022 (which will immediately contribute nicely to the bottom line as the LNG charter rates are still rather strong at $70-80,000/day, despite dropping about 60%-70% from their recent high). So long story short, Q3 was quite bad for Tsakos.

But here's why I'm increasing my exposure to the oil tanker sector. Less than two years ago the charter rates for VLCC, Suezmax and Aframax vessels were sky high but have collapsed ever since and the YTD spot rates were a negative $2,400/day, a negative $4,400/day and a positive $7,200/day, respectively.

Fortunately, the future looks brighter as the time charter rates are improving substantially. As you can see in the image below, a charterer looking to fix a Suezmax for a period of three years will have to pay $27,500/day while the VLCC rates for a three-year charter are currently about 70% higher than one-year charters.

ALIBRA
Shipping Limited

Updated Wednesday 22 December 2021

*3 & 5yrs inc. scrubber & eco tonnage

WET TIME CHARTER ESTIMATES ($/pdpr)

SIZE	1 YR	2 YR	*3 YR	*5 YR
HANDY	11,250	12,250	14,500	14,500
MR IMO3	12,000	13,500	16,500	16,500
LR1	13,500	15,250	17,250	17,500
LR2	16,500	19,750	24,950	26,000
AFRA	16,000	18,750	23,500	25,000
SUEZ	18,250	21,000	27,500	27,000
VLCC	21,500	26,000	36,000	37,500

Source: hellenicshippingnews.com

As Tsakos Energy Navigation predominantly has Suezmax (14) and Aframax (19) vessels, those two categories will be important while the three LR2 vessels and 10 LR1 vessels are also due for a price bump upon rechartering. This doesn't mean Tsakos will see a bump in its revenue right away as a bunch of its vessels are already on time charters but it's starting to look like future contract renewals may benefit Tsakos. Additionally, the company could also consider to take more vessels out of spot exposure and enter them into multi-year contracts if the prices make sense.

I don't want to be exposed to the common shares so I'm sticking with the preferreds

While I admit that owning the common shares will provide the most torque in case my investment thesis plays out, I'm not so sure I'd be comfortable being a common shareholder. The Tsakos management doesn't seem to care too much about smaller shareholders as it for instance doesn't care about providing timely information to the market: The Q2 results were released more than three months after the end of June while the Q3 results were released just last week. An issue fellow SA author J Mintzmyer also raised during the conference call.

Additionally, Tsakos continues to print new shares which it sells into the market as part of its ATM offering. Tsakos issued $14.4M worth of stock during the third quarter and an additional $31.9M since the end of the third quarter. As of Dec. 16, the company disclosed there are just under 23 million common shares outstanding which is more than 15% higher than the average share count during the third quarter. As the total trading volume between Oct. 1 and Dec. 16 was just around 12.5M shares, this basically means that every fifth share that traded in that period was a new share issued by Tsakos.

While the company also issued some preferred shares, the focus has been on printing common shares which provide a cheaper cost of funding than the preferred shares which have an 8.75-9.5% preferred dividend yield. Additionally, the simple fact Tsakos is printing new common shares actually makes the preferred shares safer as the newly raised equity ranks junior to the preferred shares.

Looking at the balance sheet as of the end of September, we see the equity portion of the balance sheet totals approximately $1.35B. There are roughly 15M preferred shares at $25 outstanding so the equity portion attributable to the preferred shares is approximately $375M. This means there was about $975M of equity ranked junior to the preferred shares as of the end of September, and this will likely be closer to $1B as Tsakos continues to issue new common shares.

BALANCE SHEET DATA		September 30 2021		December 31 2020
Cash		115,627		171,771
Other assets		280,305		276,362
Vessels, net		2,510,870		2,615,112
Advances for vessels under construction		79,024		49,030
Total assets	$	2,985,826	$	3,112,275
Debt, net of deferred finance costs		1,386,752		1,500,357
Other liabilities		247,287		230,100
Stockholders' equity		1,351,787		1,381,818
Total liabilities and stockholders' equity	$	2,985,826	$	3,112,275

Source: Financial results

Tsakos Energy Navigation has three series of preferred shares outstanding. The D-series trading as (TNP.PD) have a fixed preferred dividend of 8.75% or $2.1875 per year. These preferreds are callable right now but are trading at a discount of 5-6% to par. I think it's unlikely these preferred shares will be called right now, but I would not rule it out if the charter rates indeed start to go up.

I also own the F-series, trading as (TNP.PF), which currently have a 9.5% preferred dividend which will become a floating dividend after July 2028 based on the three-month LIBOR +6.54%. The three-month LIBOR is currently 0.22% which implies that – in the unlikely event the LIBOR won't change by 2028- the preferreds will yield just over 6.75% from 2028 on. But of course, for the next 6.5 years, the owners of the F-preferreds will continue to receive $2.375 per year per preferred share.

There also is a third series of preferred shares, the E-series trading as (TNP.PE) which have a 9.25% preferred dividend which will get switched to a floating dividend based on the three-month LIBOR + 6.881% from May 2027 on. The decision to buy the F-series over the E-series was made when the F-series were trading more attractively, but at this point, it looks like the E-series may be slightly more attractive if you assume the three-month LIBOR will move up towards 0.50% or higher by 2027.

Investment thesis

I have written a few put options on Tsakos Energy Navigation but I'd like those options to expire out of the money as I don't really want to have exposure to the common shares. I think other tanker companies like Euronav are better suited thanks to the newer and larger fleet and its proven management which has earned my respect for past deals.

That being said, I do think the preferred shares could play a role in my investment strategy. The capital gains upside is limited (although especially the fix-to-float preferreds may trade above the $25 par value). While the preferred dividends are currently not covered by the earnings, a bump in the charter rates could change Tsakos' fortunes rapidly which could make the preferred shares the desired asset. I don't mind Tsakos issuing more common shares as part of its ATM program as that actually makes the preferred shares safer.

I have a long position in the D and F preferred shares and may continue to accumulate.