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A Preference for Preferred

A case study of Ratos' preferred stock issue*

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ABSTRACT

Our thesis chronicles the events leading up to Ratos' issuance of preferred stock in June 2013, and analyzes the market environment under which the issue took place. The study aims to identify factors that influence the choice to issue preferred stock in a Swedish context. Through a single case study, we investigate the direct and indirect factors that contributed to Ratos' financing decision. We find that the decision process faced a number of constraints, such as a no-debt policy, a low market value of equity, and a wish to keep dividend payments to common shareholders. Moreover, the opportunity to dictate the issuance terms to reflect the properties of the desired security and accommodate market trends, played an important role when Ratos decided on preferred stock. Our findings do not confirm nor refute existing theories on preferred stock issuance or capital structure. However, the study shed light on how financing decisions arise in the cross-section between financial and non-financial considerations, and might provide guidance for future research on preferred stock issues in listed corporations.

Keywords: Capital structure, case study, corporate finance, preferred stock

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1. Introduction

On May 27th 2013, the private equity conglomerate Ratos announced its intention to issue 830,000 shares of preferred stock. Over the last six months, Ratos had acquired Aibel (December 2012), Nebula (March 2013), and HENT (May 2013). Ratos had limited opportunities to internally finance its new acquisitions, given poor underlying performance in the portfolio companies and weak exit markets. At a price of 1,750 SEK per share, the issue would raise 1,425 MSEK gross of fees if fully subscribed, approximately 12.5% of the equity outstanding. Ratos was the first blue chip company in Sweden to issue preferred stock. Although preferred stock issues had a successful track record in the public Swedish markets, some analysts and investors questioned if this was a suitable security for Ratos' business. Moreover, some questioned why the company would issue a new security, rather than opting for common equity or a bank loan.

Preferred stock is a hybrid security, which is junior to debt, but senior to common equity in the capital structure. While preferred stock has resurfaced in public capital structures in Sweden over the last decade, little efforts have been made to study the security in a Swedish context. To our knowledge there are no published academic articles on listed preferred stock in Sweden to this date.[1] Our thesis contributes to the scarce literature on preferred stock in Sweden, and addresses the following research questions:

What factors influenced Ratos' decision to issue preferred stock, and how do these factors relate to one another?
What purpose does preferred stock fulfill in Ratos' capital structure?

We find that the decision process faced a number of constraints, such as a no-debt policy, a low market value of equity, and a wish to keep dividend payments to common shareholders. We conclude that Ratos chose to issue preferred stock to circumvent the potential negative effects of deviating from the no-debt policy, issuing common stock, or wiping out its annual dividend payments to common shareholders. The preferred stock has debt-like characteristics – straight, redeemable with a distinct maturity and fixed dividend. Hence, Ratos was able to indirectly increase its leverage, without actually increasing its financial risk corresponding to a debt issue. The introduction of a new security expanded Ratos' investor base to include fixed income investors, and enhanced Ratos' ability to utilize and time favorable market conditions outside the equity markets. Moreover, the issue enabled Ratos to create goodwill amongst its investors and stakeholders. Lastly, the issue was sufficiently small to only make a dent in Ratos' ownership structure and payout policy.

[1] However, Persson and Yüksel (2014) investigate the common stock announcement return of preferred stock issues in Sweden, in their bachelor thesis at Uppsala University.

1.1 Scope

The main purpose of our thesis is to provide an in-depth understanding and analysis of what factors contributed to Ratos' financing decision. The secondary purpose of our thesis is to provide the Department of Finance at Stockholm School of Economics with a foundation to develop a case study suitable for learning purposes. This affects the scope of our study, as we consider a broad set of theories and angles in order to cover important empirical aspects with regard to the possible interpretations of Ratos' situation. This includes aspects that could be considered beyond the scope of the research questions, such as the analysis of Ratos' actual financing need and the market's reception of the offering. However, we do not take a stance on whether the decision to issue preferred stock was the economically optimal decision. Furthermore, we do not value Ratos or its underlying portfolio. Hence, any comments with regard to valuations are merely a replication of stakeholders' interpretation of Ratos' value at the time.

1.2 Contribution

As the basic theories of capital structure have not changed much since Modigliani and Miller (1958 and 1963) and Myers and Majluf (1984), a large body of research addresses the binary decision to issue either equity or debt. Nevertheless, there is a wide range of hybrid securities and alternative financing schemes available to corporations that are not confined by the absolute properties of equity and debt. While a lot of articles investigate the use of hybrid securities in private companies, especially as incentive alignment in venture capital, there seems to be less scholarly interest in the use of hybrid securities in listed corporations. Research on preferred stock issued by listed companies is mainly restricted to the U.S., where scholars tend to focus on the implications of country-specific legislations, such as the exemption of taxes on preferred stock dividends. Hence, there is little empirical evidence applicable to listed preferred stock issues outside the U.S. Our thesis contributes to the scarce literature on preferred stock issues in listed corporations and in a Swedish context. Moreover, while previous studies analyze the use of preferred stock quantitatively and theoretically, few studies explore the reasoning behind a preferred stock issuance on a firm level. Our thesis contributes to an in-depth understanding of the factors influencing the decision to issue preferred stock.

1.3 Outline

Section 2 establishes the theoretical framework and reviews previous research. Section 3 discusses the applied methodology and its limitations. Section 4 establishes the case background. Section 5 presents and analyzes the case. Section 6 discusses the case findings. Section 7 makes concluding remarks on the specific research questions, and makes suggestions for further research.

2. Previous Research

2.1 Capital structure

2.1.1 An introduction to capital structure

The seminal work of Modigliani and Miller (1958) suggests that the mix of equity and debt in the capital structure is irrelevant to firm value in a world with perfect capital markets and no taxes. As debt increases the company's financial risk and hence shareholders' required return, the company's cost of capital remains unchanged. When relaxing these constraints to include taxes, debt increases firm value with the value of the interest tax shield arising from tax-deductibility of interest payments.[2] But if tax deductibility of interest is a strong incentive for corporate borrowing, why don't we observe infinite amounts of debt on corporate balance sheets? As financial risk increases with leverage, Myers and Majluf (1984) suggest that companies choose an optimal debt level based on the *trade-off* between the value of the interest tax shield and the cost of financial distress. Hence, the *trade-off theory* suggests that a company will have a target debt-ratio given the characteristics of the underlying business, such as the cyclicality of cash flows and tangibility of assets. However, observed debt ratios tend to vary far more across companies and within industries than the trade-off theory suggests. Myers and Majluf (1984) suggest that this is due to the asymmetric information of capital markets, which lead companies to prefer internally generated funds to finance their investments before they resort to debt and equity markets. As the financing deficit (defined as the difference between internally generated funds available and the cost of the investment) increases, *"… the firm will work down the pecking order, from safe to riskier debt, perhaps to convertible securities or preferred stock, and finally to equity as a last resort."* (Myers 2001)

Trade-off theory and *pecking order theory* assume that managers always act to maximize shareholder value. However, *managerial capitalism*, the separation of ownership and control, might influence financing decisions due to the different properties of equity and debt (Jensen and Meckling, 1976). Debt increases firm value, as debt disciplines managers and induces monitoring by creditors. But high leverage might also lead to agency costs between equity and debt holders in the case of financial distress. Underinvestment occurs when shareholders reject positive NPV investments, as debt holders will receive most of the pay-off as prioritized claimants (Myers, 1977). Conversely, financial distress might also lead to asset substitution. Asset substitution occurs when shareholders accept highly risky investments, increasing the underlying volatility of their call option on the company value. Shareholders have nothing to lose as residual claimants, while debt holders prefer moderate risk investments to ensure that their stake is not lost (Jensen and Meckling, 1976; Green, 1984; Leland and Toft, 1996).

2.1.2 Literature review

Several studies, e.g. Rajan and Zingales (1995), find correlation between firm-specific variables and debt levels in accordance with the *trade-off theory*, e.g. positive correlation between tangibility of assets and debt. However, these

[2] However, Miller (1977) proves that the theoretical irrelevance argument also hold up in a world with tax-deductible interest payments. The main argument is that the tax on capital gains and dividends tend to be lower than the tax on interest income. Hence, the tax advantage of equity to investors can fully offset the increase in firm value due to the interest tax shield.

studies also identify patterns relatively incompatible with the *trade-off theory,* such as the negative correlation between profitability and debt, which is more likely to be explained by the *pecking order theory*. Shyam-Sunder and Myers (1999) test both the *pecking order theory* and the *trade-off theory*. Neither models are rejected when tested independently, but the *pecking order theory* has much higher explanatory power than the *trade-off theory*.[3] Fama and French (2002) confirm the negative correlation between profitability and leverage found by Rajan and Zingales (1995). However, they also find that companies with more investment opportunities have less debt (market value), which supports the prediction that growth firms have lower debt levels to avoid the underinvestment problem, in accordance with the *trade-off theory.* In a subsequent article, Fama and French actually refute the *pecking order* prediction that companies prefer debt to equity: "*We estimate that during 1973–2002, the year-by-year equity decisions of more than half of our sample companies violate the pecking order"* (Fama and French, 2005). Rajan and Zingales (1995) also find negative correlation between market-to-book ratios and debt levels, mainly driven by large equity issuers. They find this puzzling and suggest that the low debt ratios are temporary, due to timing of equity issues when prices, and hence market-to-book ratios, are high. Baker and Wurgler (2002) investigate how this equity market timing affects capital structure, and find that companies with debt levels raised funds when equity values were high and vice versa. They propose a new stance on capital structure theory, which suggests that capital structure evolves from companies' past attempts to time capital markets, known as the *market timing theory*. Frank and Goyal (2009) examine the relative importance of 39 different factors with regard to debt decisions in listed U.S. companies. They find low support for the *pecking order* and *market timing theory*, but consistency with the *trade-off theory*.

Graham and Harvey (2002) survey 392 managers on what factors they consider when making financing decisions. The most important factors affecting debt policy are financial flexibility, credit ratings, and earnings and cash flow volatility. The most important factors affecting equity issuance are earnings per share dilution, recent stock price appreciation, and maintaining a target debt-equity ratio. Graham and Harvey (2002) find very little evidence that executives are concerned with asset substitution, asymmetric information, transaction costs, free cash flows, or personal taxes.[4] However, the authors suggest that the deeper implications of financing choices might already be embedded in prices and credit ratings, and hence executives act upon these measures indirectly, rather than considering them direct factors (Graham and Harvey, 2002).

2.2 Preferred stock

Preferred stock has been part of U.S. capital structures ever since the 1830s (Evans, 1932). In its earliest form, preferred stock had the properties of a common stock, except from a dividend preference. In most cases it was automatically converted to common stock after a short period of time. Since its inception, preferred stock has evolved into a complex security with several optional properties. While preferred stock is a relatively common part of private company's capital structures today, particularly as incentive alignment between investors and owner-managers in venture capital, the prevalence of listed issues have varied with the state of the financial

[3] However, they also acknowledge that the explanatory power of the *pecking order theory* might be attributable to sample selection bias.
[4] As suggested by Miller (1977)

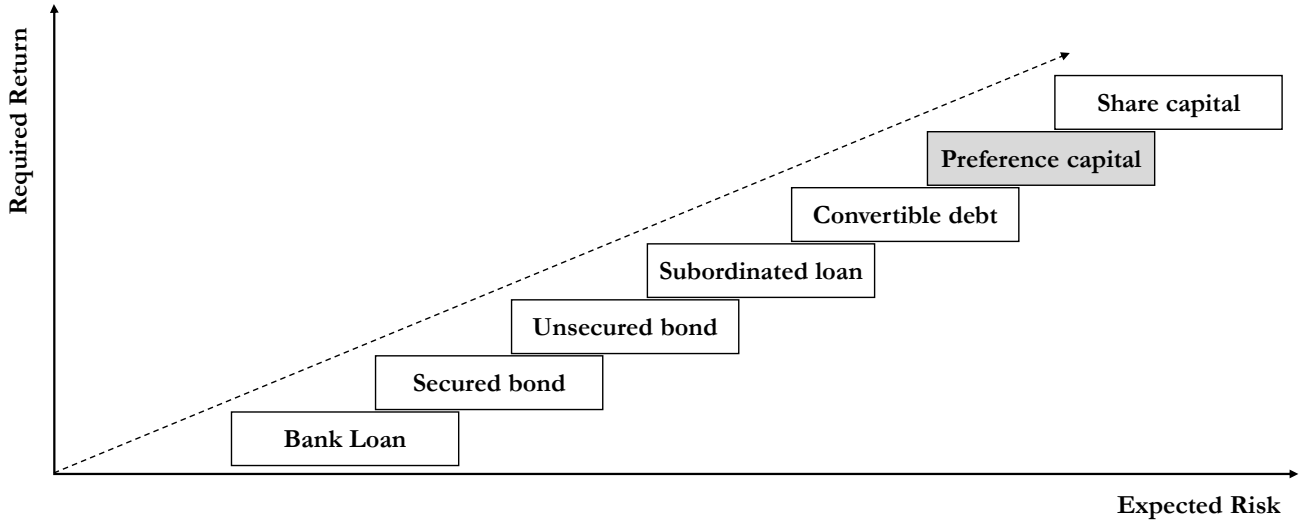
markets and across time (Pinches, 1970; Cox, 1993; Fischer, 1968). In more recent times, preferred stock has reappeared in U.S. public markets. Between 1985 and 1999, U.S. companies raised $324.63 billion through 2,636 preferred stock offerings. In contrast, over the same period of time U.S. companies raised $606.03 billion through 7,017 seasoned equity offerings (Bajaj et al., 2002). Furthermore, preferred stock was an important part of the U.S. Troubled Asset Relief Program (TARP) in the aftermath of the financial crisis. The troubled banks issued preferred stock to be purchased by the U.S. government in order to stabilize banks' capital structures and prohibit further systemic collapses in the banking sector (Kallberg et al., 2013). Preferred stock is not prevalent to the same extent in Europe. The Russian Federation has the largest number of preferred stock outstanding, with 167 listings out of a total sample of 281 preferred stocks in Europe (Thomson Reuters Datastream).

2.2.1 An introduction to preferred stock

Preferred stock is a hybrid security with senior claim on fixed rate dividends relative to common stock. Moreover, preferred shareholders have senior claim on assets in the event of liquidation, and hence preferred stock is junior to debt, but senior to common equity in the capital structure (Berk et al., 2011). Preferred stock is legally treated as equity, but as a financial instrument it has more in common with debt (Berk et al., 2011). Like debt, preferred stock offers a fixed dividend (coupon), and is thus sensitive to changes in market interest rates. On the other hand, dividend payments are not considered a mandatory obligation, and hence failure to pay dividends does not constitute a default event. From an investor perspective, preferred stock is most similar to debt when the issuing firm is financial healthy. When the issuing firm's financial stability weakens, preferred stock becomes more similar to equity, as the risk of failure to meet the obligations on the security increases.

Preferred stock carries a number of different properties, defined by the terms of issuance. Convertible preferred stock converts to common stock after a specific period of time. Conversion is either mandatory or voluntary, at a fixed price or market price at the time of conversion. Redeemable preferred stock can be bought back after a specific period of time, usually at a fixed rate of the issue price. Redemption is mandatory or voluntary, dependent on the specific terms of the stock, and usually only initiated by the issuer. Cumulative preferred stock implies that any dividends outstanding to preferred shareholders are carried forward and must be paid before any dividends can be paid to common shareholders (Berk et al., 2011). Given its limited cash flow rights, and hence limited exposure to the underlying risk of the company, preferred stock usually carries limited or no voting rights. Hence, preferred stock is sometimes interpreted as an anti-takeover device in the capital structure (Houston and Houston, 1990).

Figure 1
Preferred stock in the capital structure



2.2.2 Literature review

Modigliani and Miller (1966) analyze the effect of preferred stock on firm value in electrical utilities companies, and find that preferred stock is irrelevant to firm value. As dividends are not tax-deductible, the lower cost of preferred stock should be completely offset by the higher return required by common stockholders for assuming a higher degree of financial risk. If this holds, common stockholders should be indifferent to financing with preferred stock. Moreover, the literature suggests that the lack of tax-deductibility of preferred dividends have significant impact on which types of companies that issue preferred stock, and under what circumstances. Moyer et al. (1987) investigate the relation between financial distress and preferred stock issuance. Their results support the financial distress-hypothesis, which suggest that companies threatened by financial distress are more likely to issue preferred stock (Donaldson, 1962). If a company expect negative earnings, the tax deductibility of interest becomes less important relative to the reduced risk of forced bankruptcy from preferred stock. Rao and Moyer (1992) examine the common stock reaction of companies calling non-convertible preferred stock. They find no reaction when a company makes a partial repurchase of preferred stock outstanding. However, they do find a positive announcement effect when preferred stock is fully removed from the capital structure. Rao and Moyer attribute this to a signaling effect. The full removal of preferred stock signals positive earnings prospects, as the company is expected to replace preferred stock with debt in order to utilize interest tax shields, which subsequently should increase firm value. Houston and Houston (1990) find that companies issuing preferred stock tend to have significantly lower tax rates than market averages. Similarly, Ely et al. (2002) find a negative correlation between proxies for tax payments, and the probability of a preferred stock issue. Moreover, in a Miller-equilibrium (Miller 1977), companies with below average tax rates have an incentive to issue preferred stock to a clientele of investors with high tax rates, as income from preferred stock dividends are partly tax exempt in the U.S. (Houston and Houston, 1990). One motive to issue preferred stock is thus a clientele effect. In Sweden, preferred stock dividends

are taxed equal to common stock dividends. Thus, the clientele effect from taxes does not serve as a motive to issue preferred stock in a Swedish setting.

Heinkel and Zechner (1990) examine the impact of preferred stock on a company's investment decisions. Their model shows that high debt ratios create incentives for underinvestment (in accordance with Myers, 1977), while high equity ratios create incentives for overinvestment, i.e. a free cash flow problem (in accordance with Jensen and Meckling, 1976). Another factor included in Heinkel and Zechner's model is the dividend flexibility of the preferred stock, which Emanuel (1983) states is a key feature from the common stockholders' point of view. Heinkel and Zechner show that preferred stock enhances a company's debt capacity, and hence resolve the underinvestment problem, if debt is replaced with preferred stock in the capital structure. Similarly, Nance et al. (1993) argue that preferred stock reduces a firm's probability of financial distress.

Howe and Lee (2006) and Lee and Johnson (2009) study the long-run performance of preferred stock issuers' common stock. While common stock tend to underperform three to five years after a new issue of equity and debt, Howe and Lee only find significant underperformance of common stock up to one year after the issue of preferred stock. Utilities and industrial companies drive most of the underperformance, while financial companies tend not to underperform. Lee and Johnson link the common stock performance to issuers' operating performance, and show that the issuers' profitability declines up until the issuance and recover after the issuance. They also study the characteristics of preferred stock issuers, and show that issuers have higher capital expenditure and R&D-expenses relative to assets than non-issuing companies.

Linn and Pinegar (1988) study the announcement returns to common stock of different types of issuers and find that market reactions differ depending on the type of company and preferred stock issued. As utilities have a long track record of preferred stock issues, new issues are anticipated by the market and do not affect the value of the common stock. Financial companies generally issue adjustable rate preferred stock, and the announcement effect to common equity is positive. The authors attribute this effect to higher incentives to issue preferred stock, due to specific legislations related to taxes and capital adequacy. Industrial companies in the sample predominantly issue convertible preferred stock. These issues are often interpreted as negative information regarding the firm's earnings predictions, and hence the announcement return to common stock is negative (Linn and Pinegar, 1988). Kallberg et al. (2013) examines the announcement returns to common stock and debt holders of a preferred stock issue. They find a negative announcement effect on common stock, which is reduced with increasing credit worthiness and transparency. Moreover, they find a positive announcement effect on debt, credit default swap-spreads decrease upon announcements.

In summary, the literature on preferred stock suggests mixed motives and effects of preferred stock issues. However, it is worth noting that previous research is relatively scarce and mostly restricted to U.S. samples.

3. Methodology

3.1 Empirical methodology

The current literature on capital structure and preferred stock predicts what determines preferred stock issuance, and try to reason why these determinants should matter. Nevertheless, the current literature seldom peaks behind the curtain and ask managers how financing decisions are made. Both Weston (1955) and Miller (1977) suggest that financing decisions involve psychological and social factors, and hence case studies might be an alternative, and maybe even more fruitful, way to investigate financing decisions in corporations.

> *"Many teachers of business finance are skeptical about the existence or possibility of theories of financial policy. To support their position, they emphasize both the wide range of influences on financial decisions and their varying importance from one situation to another. The subjectivity of many factors makes them dependent on the psychological makeup of the decision-maker."* Weston (1955)

> *"Given the complexities of the real-world setting, actual decision procedures are inevitably heuristic, judgmental, imitative and groping even where […] they wear the superficial trappings of hard-nosed maximization. On this score, has there ever been any doubt that the Harvard cases […] give a far more accurate picture of the way things really look and get done out on the firing line than any maximizing 'model of the firm' that any economist ever drew."* Miller (1977)

Our methodology of choice is a single qualitative case study, which offers an interesting opportunity to get an in-depth understanding of the decision to issue preferred stock and uncover the interplay between the different stakeholders and factors considered in the decision and issuance process. Case studies have repeatedly been criticized as a proper scientific method, as it provides little generalizable results (Yin, 2003). However, Dubois and Gadde (2002) argue that interaction between a phenomenon and its environmental context is best understood in in-depth case studies. Siggelkow (2007) supports this view and emphasizes that case studies have different objectives than empirical studies: "*The main object of case studies should be to provoke thought and new ideas, rather than to poke holes in existing theories."* A case study might also include several cases, but we choose to study one specific case to allow for a better understanding of the specific case, in accordance with Dyer and Wilkins (1991).

A deductive research approach moves tests hypothesis based on previously defined theories, which is subsequently rejected or confirmed through analysis of data. An inductive research moves in the reverse direction, where observations are analyzed to form general theories (Bryman and Bell, 2011). An abductive research approach is based on an interchangeable process between deductive and inductive logic. Our research approach is based on this systematic combining of deductive and inductive reasoning, as recommended for single case studies by Dubois and Gadde (2002).

3.2 Data collection

Interviews serve as our primary source of data. In order to form a complete picture of the case at hand, we interviewed individuals representing parties involved in the issuance, as well as independent parties such as equity research analysts and other companies with mandates to issue preferred stock. We selected interviewees representing dependent parties conditional on their involvement in the issuance and availability, and independent parties based on their knowledge of Ratos and preferred stock. Given these criteria, we interviewed two persons in Ratos' management who were fully involved in the process, Ratos' financial advisor and book-runner, three independent analysts, and two investors. Most investors declined to participate in interviews, due to compliance, and the two investors participating in the study have chosen to remain anonymous.

Table 1
Interviewees

Interviewee	Company	Role	Dependence
Bo Jungner	Ratos	Vice CEO	Dependent
Emma Rheborg	Ratos	Director of Communications	Dependent
Alexander Ensér	Handelsbanken	Head of Corporate Finance Sweden	Dependent
Christian Hellman	Carnegie	Equity Research Analyst	Independent
David Halldén	UBS	Executive Director	Independent
Elias Porse	Nordea	Equity Research Analyst	Independent
Lena Krauss	East Capital Explorer	Head of Finance & IR	Independent
Erik Nerep	Stockholm School of Economics	Professor, Center for Business Law	Independent
Investor I	Major nordic bank	Fund manager*	Independent
Investor II	Private investment firm	Portfolio manager**	Independent

*Swedish equity fund focusing on short-term returns
**Long-term value investor, focusing on debt instruments

As interviews serve as our primary source of data, we put a high effort into preparing, conducting and subsequently documenting the interviews. We prepared individual interview guides for each interviewee, as the purpose was to cover the areas of the issuance where each interviewee could contribute the most. However, some questions reoccurred in all interview templates. When interviewing Ratos' management we covered Ratos in general, Ratos' financing strategy, and the decision process from idea to issue. When interviewing research analysts we focused on how they value Ratos, their thoughts on the issuance, and their general view of preferred stock. During the interviews we used the interview guide as a starting point, but encouraged the interviewees to talk freely about the specific case and preferred stock in general. Hence, the interviews are best described as semi-structured (Merriam, 1994). The approach enabled us to develop an understanding of new perspectives brought up in the interviews, and to ask the necessary follow-up questions. Moreover, we extended our selection of interviewees in order to enhance the understanding of issues and questions encountered along the way, such as Lena Krauss at East Capital Explorer and Erik Nerep at the Center for Business Law. The interviews took place in March and April in 2014, with an average length of one hour (60 minutes). We discussed all interviews within twelve hours, with the original interview guide and the written notes from the interviews as discussion papers. Moreover, we recorded and

transcribed all interviews word for word within forty-eight hours, in order to preserve the impressions from the interviews. Following the transcription of each interview, both authors sat down to go through the transcribed material. All interviewees agreed to answer follow-up questions or provide further data, if necessary. We took this opportunity with several interviewees, mainly to collect complementary data.

We support the interviews with data collected from both public and private sources, such as internal and external documents and confidential material. External documents include Ratos' financial reports and issuance prospectus, press releases, equity research reports, transcribed conference calls and general media coverage of Ratos and the issuance. The documents served both as background information on the case and preparation materials for the interviews. Moreover, they significantly enhanced our understanding of the case, which allowed us to both challenge statements and ask follow-up questions during interviews. Confidential materials are described when applicable, though we are unable to publish the obtained data itself.

3.3 Reliability and validity

The choice of methodology affects the reliability of our study in several ways. Interviews are affected by the setting of which interviews take place, and semi-structured interviews even more so, as they are affected by the interaction between interviewers and interviewees. Furthermore, the data collected in interviews requires interpretation, which is highly subjective. Moreover, as the case study refers to a single event at a single point in time, the interviewees might recollect the event differently in a later study. These factors reduce the possibility that a replication of the study would lead to the same results.

In qualitative research, validity refers to whether the findings of a study accurately reflect the situation and are supported by evidence (Stenbacka, 2001). Stenbacka (2001) and McMillan and Schumacher (2009) suggest triangulation, i.e. analyzing the research question from multiple perspectives, as an appropriate method to increase validity in qualitative studies. Hence, in order to increase the validity of our study we used multiple sources of information in the data collection. We conducted in-depth interviews with all detected groups of stakeholders involved in the issuance. To further increase the validity, we also interviewed unrelated parties and subsequently determined the areas of agreement and divergence among the dependent and independent interviewees. While we find inconsistencies in some areas, we do not consider this weakening the validity of the study. Rather it strengthens the inner validity[5], as it reveals the complexity of the issuance process and uncovers an opportunity to find deeper meaning in the data (Merriam, 1994). Furthermore, all interviews were made in person with both authors present. One of the authors was primarily responsible for leading the interviews, while the other author took notes, made sure that the interview covered all relevant topics, and proposed follow-up questions when needed. The written notes complemented the transcribed interviews with our immediate impressions. With this approach we tried to capture both the body language and the spoken language of the interviewees.

[5] The ability to make causal conclusions based on a specific study.

Single case studies do not yield generalizable results, as they do not represent a sample (Silverman, 2013). Hence, single case studies have limited external validity[6]. Ratos' characteristics, which make the company especially suitable for a case study, also enhance the difficulty to make any generalizable conclusions. Hence, our conclusions are only valid in the context of Ratos. However, we believe that the motives behind the decision to issue preferred stock bear similarities to other issues in Sweden at the same point in time, and therefore can provide hints, and serve as motivation for future research within the same field, as proposed by Siggelkow (2007).

[6] To which extent generalizable conclusion can be made based on a specific study.

4. Case Background

The following section serves an introduction to the market for preferred stock in Sweden and, most importantly, an introduction to the case company, Ratos.

4.1 Preferred stock in Sweden

Preferred stock has been of limited interest to the public markets in Sweden, but has resurfaced in public capital structures in recent years. While the Nordic region was less affected by the financial crisis than other economies, bank credits still tightened, given new European bank regulations and weakened trust in the financial markets. The more restrictive bank lending caused financing problems for companies accustomed to a high level of bank financing. The financing need resulted in a growing market for alternative financing, and corporate bonds and preferred stock got an upswing as suitable alternatives to bank loans. Companies in the real estate industry were particularly accustomed to high debt-equity ratios, and preferred stock seemed as a good alternative to debt financing in these companies. As it is legally defined as equity, preferred stock reduces the leverage of the property portfolio. Moreover, the fixed dividend payments correspond well with the regular cash inflow from rents. When Sagax issued preferred stock in 2006, there were no preferred stocks in the market. Between 2006 and 2013, eight different real estate companies issued preferred stock, and these transactions contributed to a more open public market for preferred stock in Sweden. The real estate companies use non-convertible redeemable preferred stock as a permanent part of the capital structure, and signal no clear time to redemption. While legally defined as equity, Investor II still believes that preferred stock should be valued as debt, given the high exposure to duration risk: *"I don't believe these securities will be redeemed any time soon. And if you view them as credit instruments, the uncertainty with regards to maturity implies a high exposure to interest rate risk. Imagine if the long interest rate increases to four or five percent! It might not happen over the next two or three years, but it's inevitable, at some point interest rates* ***will*** *increase. Then these real estate preferred stocks will take a hit and trade down substantially. And that's why I am skeptic towards them. I don't think retail investors understand this risk"* (Investor II 29.4.2014).

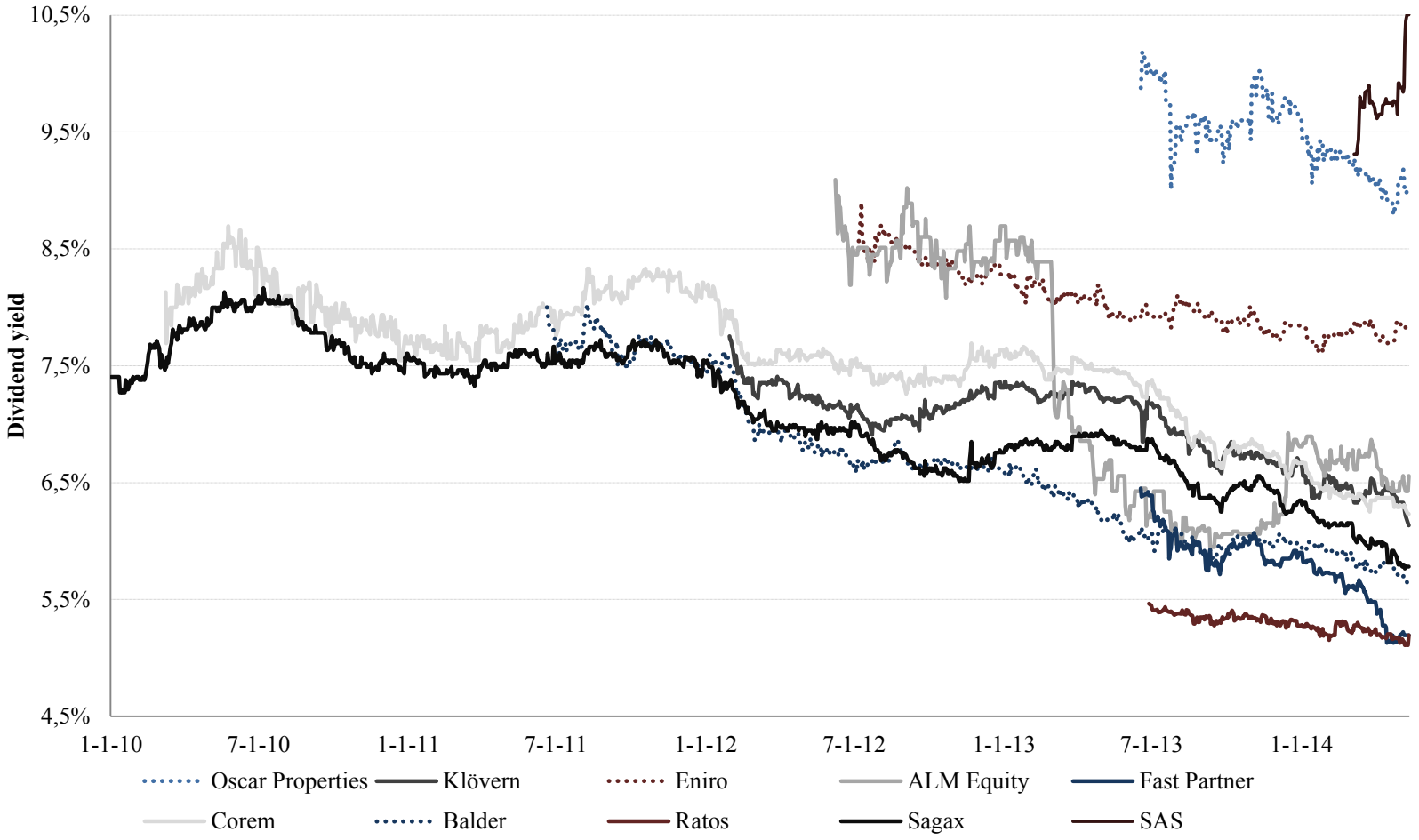
Following the successful issues in the real estate sector, preferred stock captured the interest of a wider range of investors and issuers, and eventually spread outside of the property sector. Examples of non-property issues include Swedbank (2008), Eniro (2012), Alliance Oil (2012), Ratos (2013) and SAS (2014).[7] Today, all listed preferred stock in Sweden trade at dividend yields between 5% and 10%.[8] The dividend yields have steadily decreased from issuance, with the exception of SAS. Figure 2 depicts the dividend yield development from issuance of all current preferred stocks outstanding in Sweden.

[7] Appendix D, Table D1, provides an overview of all current preferred stock in Sweden
[8] Appendix D, Table D2 provides an overview of price and dividend yields at issuance compared to price and dividend yield as of 30.4.2014

Figure 2 (Source: Thomson Reuters Datastream)

Dividend yield of listed preferred stocks in Sweden (30.4.2014)

The graph depicts the dividend yield of all preferred stocks listed at Nasdaq OMX Stockholm since issuance. (With the exception of Sagax, who issued in 2006.)



4.2 Ratos

Ratos was established as a holding company of the steel wholesaler Söderberg & Haak in 1934, and went public in 1954. In 1999, Ratos made a strategic shift from industrial conglomerate to private equity investor, and now invests in Nordic mid-cap companies across all sectors and industries, with equity investments ranging from 300 to 5,000 MSEK. The investment strategy is based on long-term, active ownership, with focus on value creation through operational improvements.[9] Ratos seek to acquire a minimum 20% equity stake in its portfolio companies[10] and achieve an average exit-IRR of 20%. While private equity funds operate with a fixed duration, Ratos has no fixed time-horizon on its investments. The current median age of Ratos' portfolio is 7 years. Ratos seek to turn over its investments within 3 to 5 years; this has later been revised upwards to 7 years given the weak transaction markets (David Halldén, 25.4.2014). Around 50 people work at Ratos head office in Stockholm. In addition, Ratos has a network of industrial advisors in the Nordic countries. Susanna Campbell succeeded Arne Karlsson as CEO in 2012. Arne Karlsson was highly regarded as the CEO of Ratos, and is still engaged in Ratos' operations as chairman of the board. Around the same time, Bo Jungner was appointed deputy CEO.

Since 1999, Ratos has made 36 exits with an average IRR of 25%. In the early years of the 2000s, Ratos sold out public investments of the portfolio to accommodate the shift in investment strategy, and made a lot of successful exits at the top of the technology bubble. Following the financial crisis global transaction markets have been weak, even disastrous back in 2009: *"There was a rebound effect in 2010, coming up from very low levels, but we saw no real recovery until the fourth quarter of 2013"* (David Halldén, 25.4.2014). The limited exit opportunities in the markets following the financial crisis have severely affected Ratos' ability to achieve its target IRR of 20%. From 2008 to 2013 Ratos reached their target in four out of twelve exits: Hägglunds Drives in 2008 (55%), Haglöfs in 2010 (30% IRR), Anticimex in 2012 (24% IRR) and Stofa in 2013 (54%). From 2008 to 2013 Ratos completed eight new acquisitions: Stofa, HL Display, KVD and Biolin in 2010, Finnkino in 2011 and Aibel, Nebula and HENT in 2013. Moreover, Ratos completed thirteen add-on acquisitions, at a total value of 2,587 MSEK.[11]

[9] Private equity firms create value through financial, governance and operational engineering.
[10] Aibel is the only investment with a minority stake (32%) in the current portfolio, co-owned with The Sixth AP Fund (Sweden) and FERD (Norway).
[11] See Appendix C, Table C4 and C5, for a detailed overview of Ratos' historical acquisitions and exits.

Figure 3 (Source: Mergermarket, 2013)
Nordic M&A activity 2007 - 2013

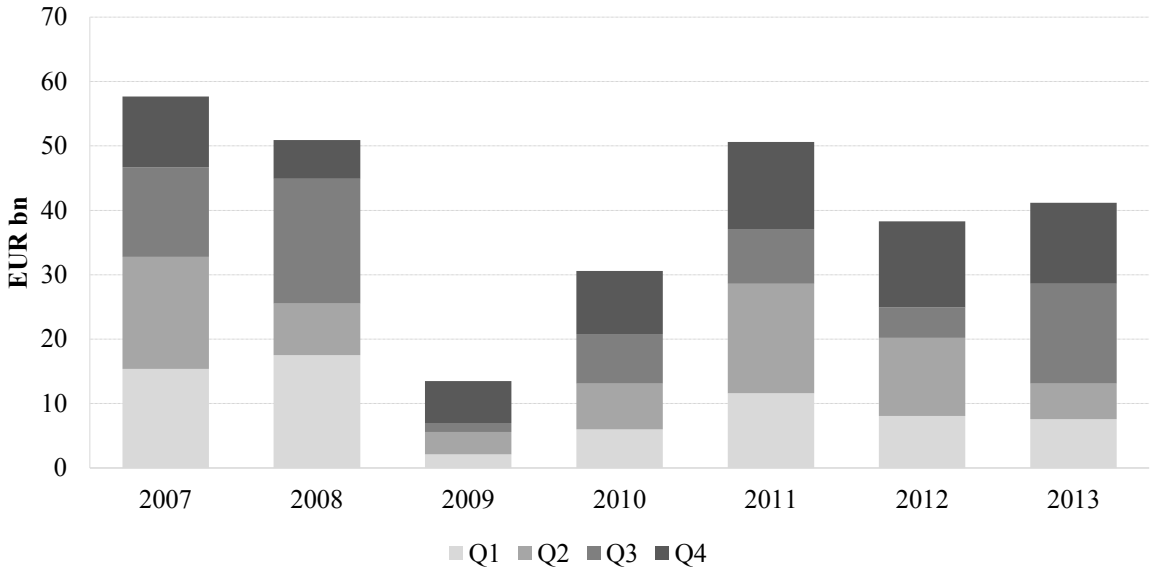


Figure 4 (Source: Mergermarket, 2013)
Nordic private equity buyout activity 2007 - 2013

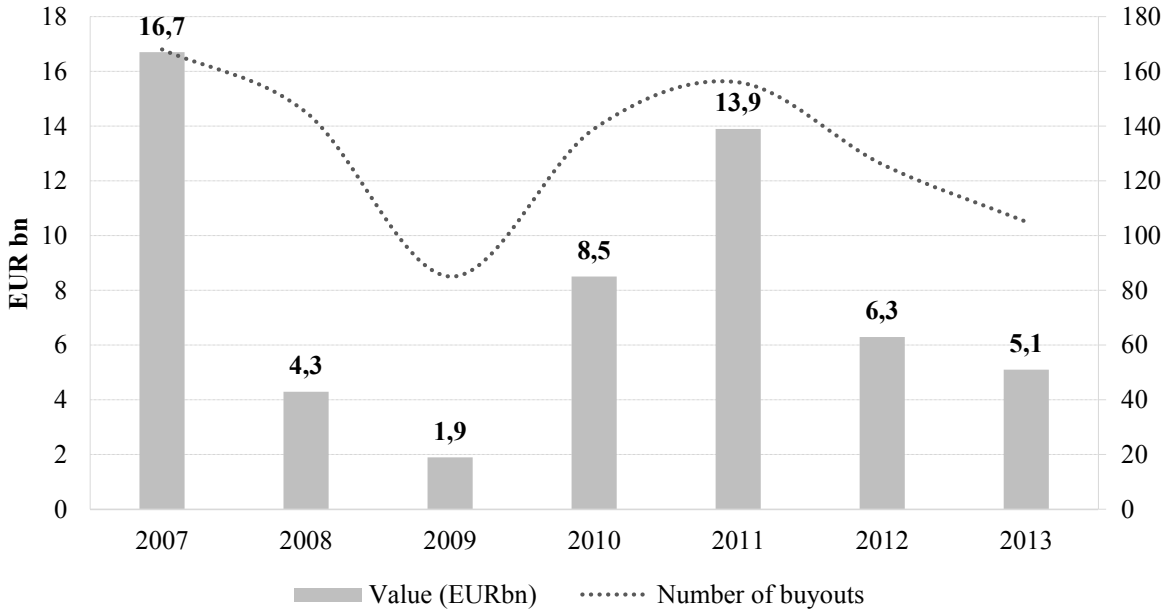


Figure 5 (Source: Mergermarket, 2013)
Nordic private equity backed IPOs 2007 - 2013

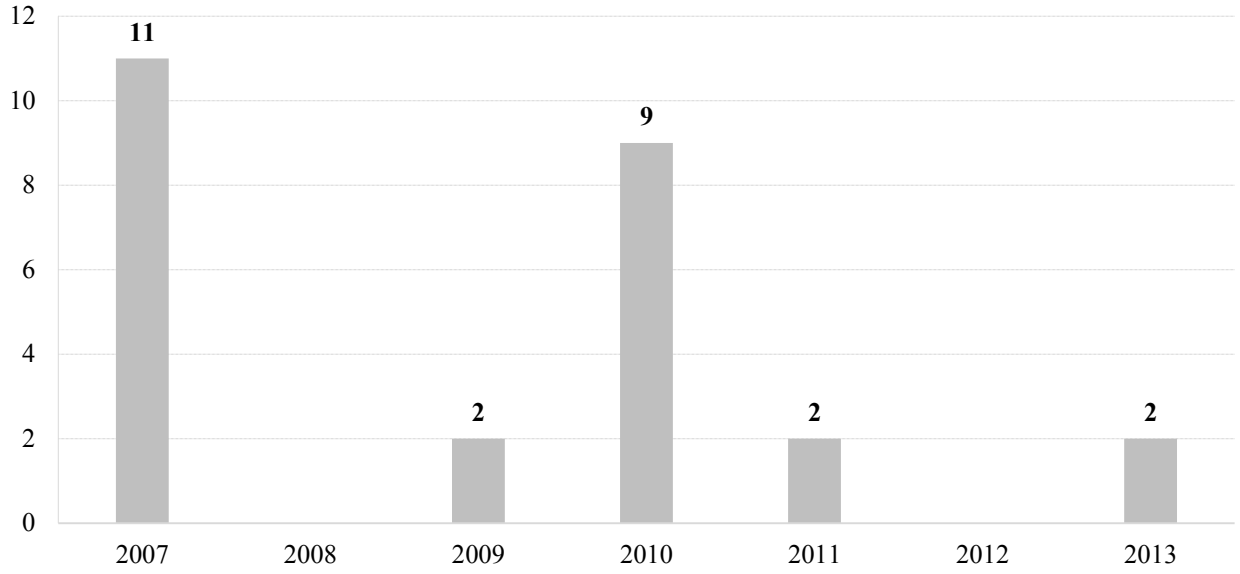
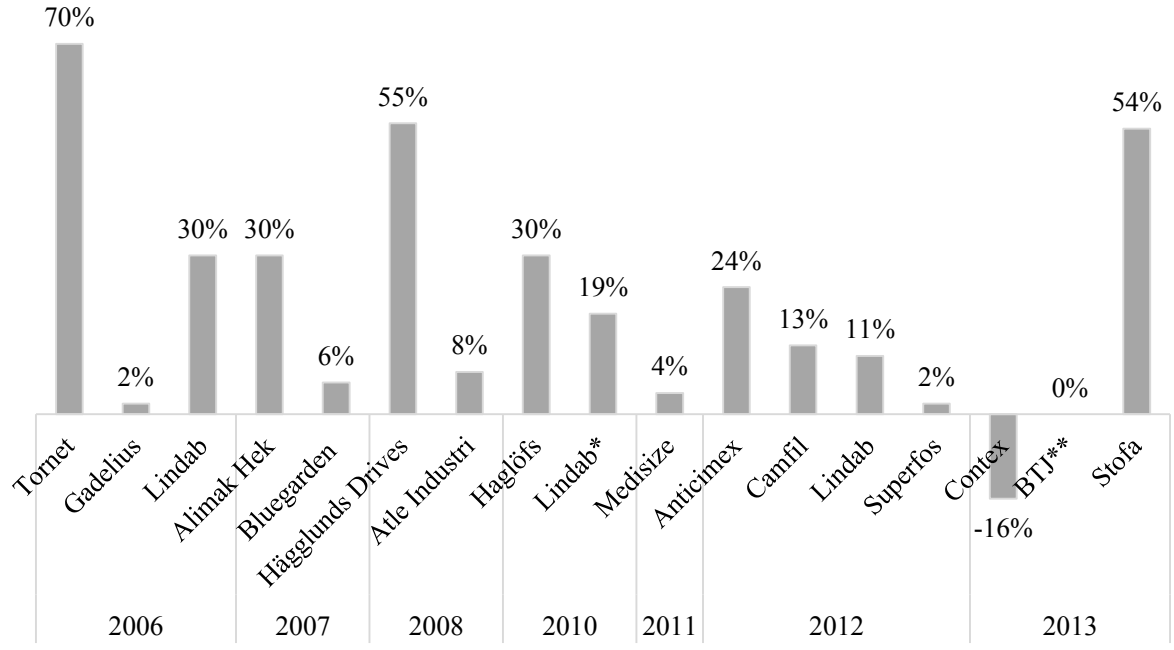


Figure 6
Ratos' exit IRRs 2006 – 2013



*Lindab: Partly divestment of remaining stake
**BTJ: Undisclosed negative IRR

4.2.1 Industry and strategy

In January 1999, Arne Karlsson wrote a memo called *"The black box – the discount to net asset value",* explaining Ratos' strategic re-focus from investment company to private equity conglomerate. Investment companies invest in a portfolio of listed companies and funds, and tend to trade at a discount to net asset value (NAV). Investors require a higher return on investment companies compared to direct investments in the portfolio companies, as they could easily replicate the portfolio themselves. Hence, if the investment company fails to add value beyond a passively managed portfolio, its stock will trade at a discount to NAV in order to achieve the return required by the investors.[12] Conversely, retail investors lack the opportunity to make direct investments in private companies. Hence, individual placements in private equity require a public market. Furthermore, there are far more market frictions and imperfections in the market for private equity. A listed private equity company should thus be able to avoid the discount to NAV, both with regard to the opportunity cost of portfolio replication and the ability to generate satisfactory excess returns. This was the reasoning behind Ratos' strategic shift in 1999. Ratos subsequently made a range of successful divestments of its public investments, and acquired the listed private equity company Atle together with 3i. Atle's portfolio companies were divided between Ratos and 3i.

Intuitively there seem to be a contradiction between being listed, i.e. being a public company, and investing in private equity. However, with a listing, private equity companies are able to diversify their sources of liquidity, obtain relatively cheaper financing, and increase their brand awareness and value. Furthermore, a listed stock put a market value on the firm, which is a useful tool when solving succession issues or designing remuneration packages, and provides a currency that can be used as direct payment in acquisitions. On the other side of the table, retail investors get a relatively liquid and diversified investment in private equity. Apart from receiving exposure to an asset class previously unavailable, investors achieve both J-curve and vintage diversification[13]. One important characteristic of listed private equity companies is that they tend to operate as 'evergreens', i.e. they don't have a fixed fund life (Cumming, 2012). Hence, listed private equity is allowed to re-invest realized returns of successful exits, so called 'capital-recycling' (Cumming, 2012). Returns to shareholders are distributed through dividends and capital gains.

Nevertheless, listed private equity also comes with several disadvantages. Private equity will always be a long-term business, regardless of the liquidity provided by a listing. While initial public offerings of private equity vehicles have been successful, trading have revealed that you can't cheat the market of its illiquidity premium.[14]

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[12] If investment company A invests in the listed company B with a required return of 10%, company A must earn an excess return on its investment in B, to be able to cover its operational costs and still return 10% to its investors. If not, A's stock will trade at a discount to NAV in order to achieve the return required by the investors. Furthermore, the investment company is expected to utilize its majority (large) stakes to significantly enhance the value of the companies in the portfolio, beyond what could be expected with a totally diversified ownership base. If investment company A does not add any excess value beyond covering its operational costs, its investors would be better off replicating the investment company portfolio herself. Hence, investment company A must earn a significantly higher return on its investment in B, to provide its own investors with a satisfactory return, compared to a direct investment in company B. (Karlsson, 1999).

[13] The success of a specific fund is a function of the current private equity cycles. Funds raised and invested during busts, significantly outperform comparable funds raised and invested during boom periods. This is due to "money chasing deals"-behavior and easy access to leverage in good times, putting upward pressure on prices. With listed private equity, rather than being invested in specific funds, smaller investment can be made across a range of vintages, both within and across private equity companies, providing the investor with desirable vintage diversification.

[14] Per Strömberg, 4310 Venture Capital and Private Equity, Fall 2013

Consequently, several private vehicles also trade at a discount to NAV. Moreover, the relatively long-term investment horizon of private equity might not correspond well with the more short-term earnings focus of public financial markets. Hence, listed private equity comes with a cash flow timing issue, as cash in- and outflows seldom match quarterly and annual reports if the private equity strategy is carried out optimally. Moreover, the total lack of reporting requirements in the private sphere let general partners manage their funds and investments far away from public scrutiny, while listed private equity requires far more transparency in order to accommodate both listing requirements, and to secure analysts and other stakeholders' understanding of the underlying business.

4.2.2 Ownership structure

The conventional view of ownership is that listed companies have dispersed ownership separating management and control of the firm (Berle and Means, 1932). In reality, however, majority family- and state ownership is far more widespread than the conventional view suggests. La Porta et al. (1990) investigate the ownership structure of the 20 largest companies in 27 of the world's largest economies and find that 30% of these are family-controlled. On average, Sweden has an ultimate family owner in 2.5 of the top 20 companies investigated, far above the full sample average of 1.33. Control is usually sustained through pyramid holding structures or dual-class share structures, i.e. shares with divergent cash flow and voting rights. Dual-class share structures result in controlling minority shareholders, i.e. shareholders with a high control stake relative to its cash flow rights. Controlling minority shareholders are especially prevalent in Swedish companies (Cronqvist and Nilsson, 2003).

Ratos went public in 1954, offering 20% of the current share capital to the public, amounting to 30.000 shares. These were Series A-shares with one share per vote and a price of 200 SEK per share (Ratos, 2013). *"The only difference between the classes of shares is the voting power. The IPO was done in the 1950'ies, and at the time you only had the option to issue shares with high voting power. All old, classic companies, Ericsson, Electrolux and Investor, did it that way. I'm not sure that's how we would do it today, but that's how it is"* (Bo Jungner, 4.3.2014). As only a minority stake was floated, dilution of family control was not an issue at the time, even with the application of one vote-one share. Ratos issued its second class of shares in 1970, Series B with one-tenth vote per share. This is the lowest dilution of voting power possible under the Swedish Companies Act. According to Bo Jungner, the low voting power in the new series had nothing to do with the desire to avoid dilution of control. Rather, it was done to facilitate foreign investments in Ratos under the current legislative environment, which restricted foreign ownership in Swedish shares.

The Söderberg-family (Söderbergs) control 70% of the voting rights in Ratos through the majority of A-shares and a substantial block of B-shares. Shares are held directly and in the family trusts, Ragnar Söderbergs Stiftelse and Torsten Söderbergs Stiftelse. Ragnar and Torsten Söderberg founded the trusts in 1960, to create a stable ownership structure in Ratos and benefit meaningful social causes (Ragnar Söderbergs Stiftelse). They donated 20.000 shares in Ratos each, worth a total of 13 MSEK at the time. Today, each trust is worth more than 2 billion SEK. Shareholders can sell Series A directly, but given the low liquidity in the share, this is seldom a desirable option. Furthermore, they have the option to convert Series A into the far more liquid Series B. As the Series A holds no clause protecting the election of a board majority, the option to convert increases the

hypothetical risk of a loss of control in the case of a hostile takeover or an activist shareholder trying to achieve a toehold. However, the conversion is done 1:1, and hence nine-tenth votes per share are lost in conversion.

Table 2
Largest shareholders (31.3.2014)

Shareholders	Capital %	Votes %
The Söderberg family with companies	18.7	46.3
Torsten Söderberg's trust	8.6	12.5
Ragnar Söderberg's trust	8.4	14.7
NTC Canadian Pension Funds Lending	1.8	0.5
Handelsbanken funds	1.6	0.5
Avanza Pension	1.6	0.5
Swedbank Robur funds	1.2	0.4
Danske Capital Sweden	1.0	0.3
AP4	1.0	0.3
Uppsala University	1.0	0.3

The Söderbergs control more than the qualified majority required at annual and extraordinary general meetings.[15] One apparent risk is that an activist shareholder could acquire the shares necessary to put the Söderbergs' qualified majority in jeopardy. David Halldén sees this risk as minuscule: *"There is perfect harmony between the majority and the minority [shareholders]. Given the family's large influence, I don't think there is any risk. Why would anyone even try?"* The family holds two seats out of seven on the board, represented by Per-Olof and Jan Söderberg. While the Söderbergs have no majority of board seats, they represent more than fifty percent of the election committee and control the AGM, which subsequently suggests and elects board members. Hence, the Söderbergs ultimately hold formal control over Ratos' daily operations. Jensen and Meckling (1976) and Shleifer and Vishny (1989) suggest that controlling shareholders with substantial voting and cash flow rights face strong incentives to monitor managers and maximize profits, as opposed to entrenching themselves on behalf of minority investors. Hence, a strong, controlling shareholder with significant wealth invested in the particular company should enhance the value of minority shares (La Porta et al., 1999). Conversely, controlling shareholders with substantial voting rights in management positions pose a large risk of expropriation to minority shareholders. Cash flow ownership mitigates some of the risk of expropriation, but does not eliminate it (La Porta et al., 1999). The Söderbergs hold far more voting power than cash flow rights, but it is reasonable to believe that a significant amount of their wealth is tied up in Ratos. Furthermore, the trusts' capital is solely made up of shares and dividends from Ratos, i.e. their wealth is directly tied to Ratos' performance. This should provide the family and trusts with a strong incentive to maximize shareholder value as controlling owners, rather than expropriate minority investors.

4.2.3 Management

The inherent trade-off between governance and ownership implies that the higher dispersion in ownership, the higher need for mechanisms securing interest alignment between managers and shareholders. As the Söderbergs

[15] Usually 2/3 of the votes and the shares present, and in ordinary cases it is ¾.

effectively control Ratos' daily operations, Ratos' management face strong monitoring from the Söderbergs relative to a dispersed ownership base. Fama and Jensen (1983) and DeAngelo and DeAngelo (1985) suggest that family control reduces the need to monitor and discipline managers. The rationale is that the strong monitoring in family controlled companies replaces the need to monitor and incentivize managers through other channels. Nevertheless, Ratos' management is also incentivized through a complex remuneration structure. Table 3 provides an overview of the different components of the compensation package, and how they relate to the comparable compensation structures of private equity funds.

Table 3

Management compensation structure

Compared to conventional compensation structure in private equity funds.

Limited partnership	Ratos
Management fee	Salaries
Carry	Stock options*
Co-investment in fund	Co-investment in portfolio companies

*Given that the stock price reflects IRR

Management's remuneration depends on (i) the overall performance of the portfolio, *"the results we actually achieve";* and (ii) the stock price performance, *"stock options, bought at market value, vesting over five years to motivate [management] to stay aboard"* (Emma Rheborg, 25.3.2014). Furthermore, management makes co-investments in all portfolio companies through synthetic stocks and options, which implies that the management actually takes personal risk in the portfolio companies. The different components of the remuneration packages ensure that the management is exposed not only to the upside risk through the compensation based on the stock price, but also to the downside risk through compensation based on the overall performance of the portfolio. *"We are unable to optimize this in any way, because if you try to make decisions that will benefit one system, you will lose in another"* (Emma Rheborg, 25.3.2014).

5. The case: Ratos' decision to issue preferred stock

The following section outlines Ratos' decision process leading up to the issuance of preferred stock in June 2013. Section 5.1 describes why Ratos needed external financing. Section 5.2 discusses the different financing alternatives Ratos contemplated, and examines the underlying motives to discard internal funds, debt and common stock. Section 5.3 covers the preferred stock issue from proposal to market reception.

5.1 Winter 2012: Financing need

On the 18th December 2012, Ratos announced its acquisition of the Aibel together with The Sixth AP Fund and FERD (Ratos, 2012b). Aibel is a Norwegian, leading provider of services to the oil, gas and renewable energy industry. The investment consortium acquired Aibel at an enterprise value of 8,600 MNOK (10,000 MSEK), x9.6 EBITDA. Ratos contributed 1,400 MNOK (1,676 MSEK), corresponding to an equity stake of 32%. Aibel was Ratos' largest, single investment as a private equity conglomerate. A press release proposing a dividend cut immediately followed the announcement of the deal. The decision to acquire a stake in Aibel and the immediate cut in dividend, combined with weak underlying growth, an aging portfolio and 'sluggish' transaction markets gave both analysts and investors headaches. Especially the acquisition of Aibel was a source of uncertainty and speculation:

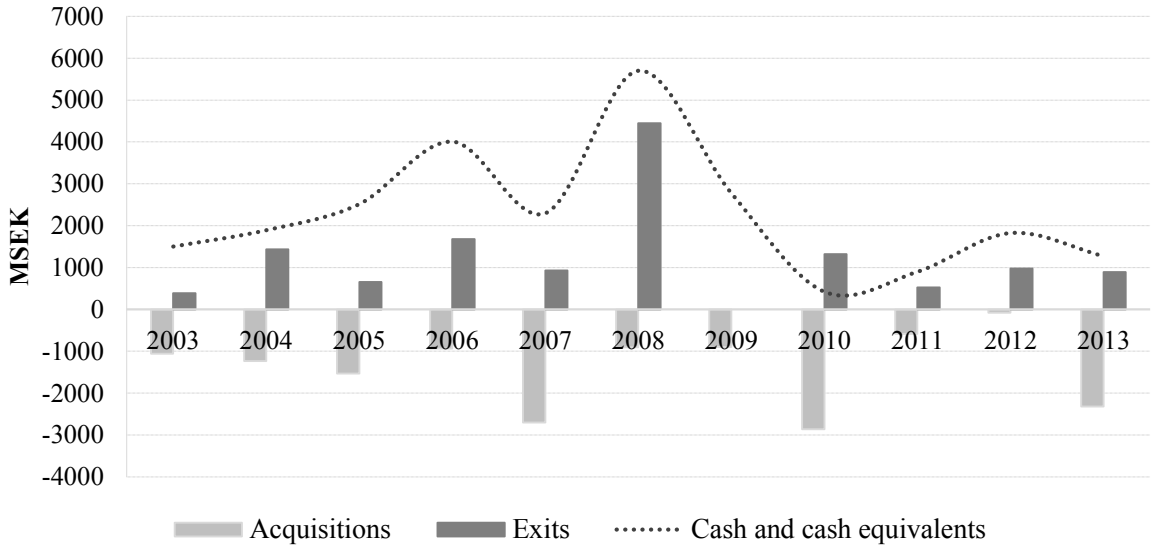
> *"There was a lot of turbulence surrounding Aibel."* Investor II
>
> *"I got an e-mail from a Norwegian analyst, who thought it was crazy and insanely expensive."* Christian Hellman
>
> *"They bought Aibel at a valuation of x9.6 EBITDA. That seems like a very expensive buy. I think it's going to take some years before they get their money back."* Elias Porse

The consensus was that the deal was completed in a market where it was difficult to do any bargains. On the buy-side, private equity funds had substantial dry powder[16] and had been under considerable pressure to close deals in 2012 (Bain & Company, 2013). Furthermore, corporate bond markets appreciated, making leverage cheaper and more accessible. Both factors increased private equity funds' willingness to pay, and put an upward pressure on buyout prices. But the cheap leverage also affected the sell-side: *"No companies went crashing down, because everyone could obtain relatively cheap financing. So in the aftermath of the financial crisis there has been few or no companies to buy cheap, but you haven't been able to sell either"* (David Halldén, 25.4.2014). The stickiness of valuations resulted in an average European deal price of x9.6 EBITDA in 2012 (Bain & Company, 2013). Moreover, European investors expecting a downfall of investment opportunities following the Eurozone-crisis were left disappointed. The market conditions were no better in the Nordic region, despite stronger underlying economic growth. Apart from the price paid, analysts worried about Aibel's dependence on the Norwegian oil and gas company Statoil, the company's largest customer.

[16] Non-deployed committed capital

At the end of 2012, Ratos held cash and cash equivalents of 1,823 MSEK (Ratos, 2012). With the acquisition of Aibel at 1,637 MSEK, an upcoming dividend payment on April 25th 2013 of 972 MSEK[17], and several deals in the pipeline, it was evident that Ratos needed financing. *"I don't think the group as a whole was liquidity constrained. […] From a creditor's perspective, there were no worries. However, if I was a shareholder, I would be a little worried about how they would run the business going forward without raising additional capital. It was clearly limited opportunities to invest otherwise"* (Investor II 29.4.2014). Ratos subsequently acquired the Finnish cloud service company Nebula in March 2013 at 284 MSEK, and the Norwegian construction company HENT at 384 MSEK in May the same year (Ratos, 2013).

Figure 7
Cash in- and outflows
Yearly exits and acquisitions (including supplementary acquisitions), and available cash and cash equivalents at year-end.



5.2 Spring 2013: Financing alternatives

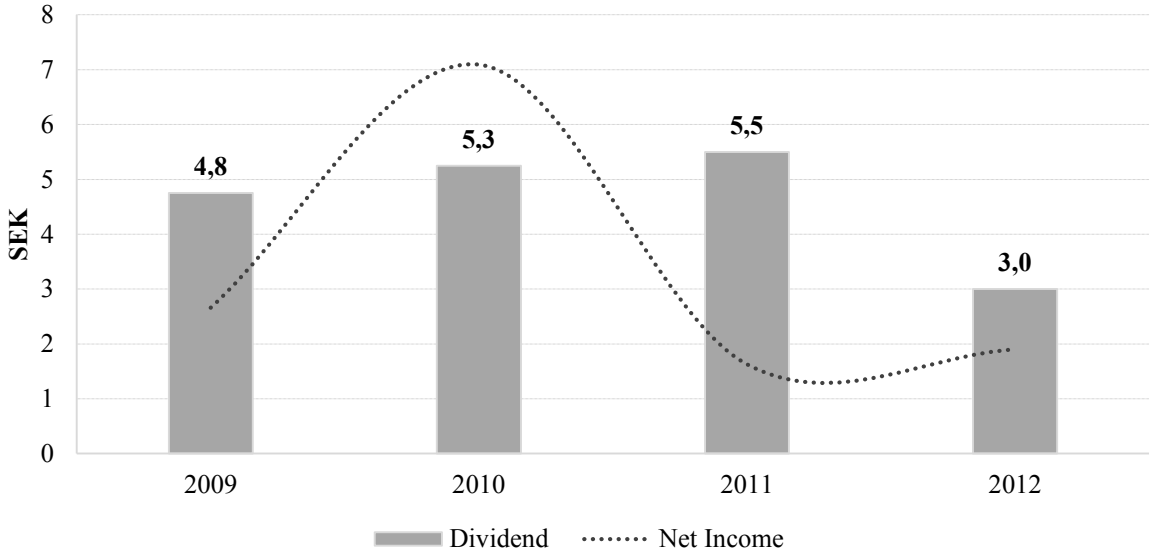
5.2.1 Internal funds

Apart from funding recent acquisitions, the upcoming dividend payment, was one of the main causes why Ratos needed liquidity. Ratos has historically been a dividend stock, paying out an average of 50% of net income to its investors. Figure 8 shows Ratos' dividend per share and dividend payments as a fraction of net income from 2009 to 2012. From 2009 to 2011, the average dividend was more than 5 SEK per share, in some years exceeding 100% of net income: "*You can either reinvest excess cash in the business or pay out dividends. A couple of years ago we did some large exits, and when we saw limited investment opportunities with a potential to reach a 20% IRR in the years that followed, we distributed the excess cash to shareholders"* (Emma Rheborg, 25.3.2014). In accordance with the proposal from the board, the AGM 2013 decided to decrease the dividend to 3 SEK per share (Ratos, 2012c). Emma Rheborg explains: *"If we continue to hand out more than 100% of our income, the business will effectively be shrinking, and that's far from our ambition."* Despite the cut, the dividend still exceeded 100% of the net income reported in 2012. *"Ratos is a large organization,*

[17] 3 SEK x (85 million Series A and 240 million Series B outstanding)

and it costs quite a lot to run the company. […] They already have a hard time covering its regular dividends, as they hand out 130% of its net income to its common shareholders. […] If they can't bring home the money, Ratos will just bleed out" (Elias Porse, 25.3.2014).

Figure 8
Dividend and Net Income (per share)



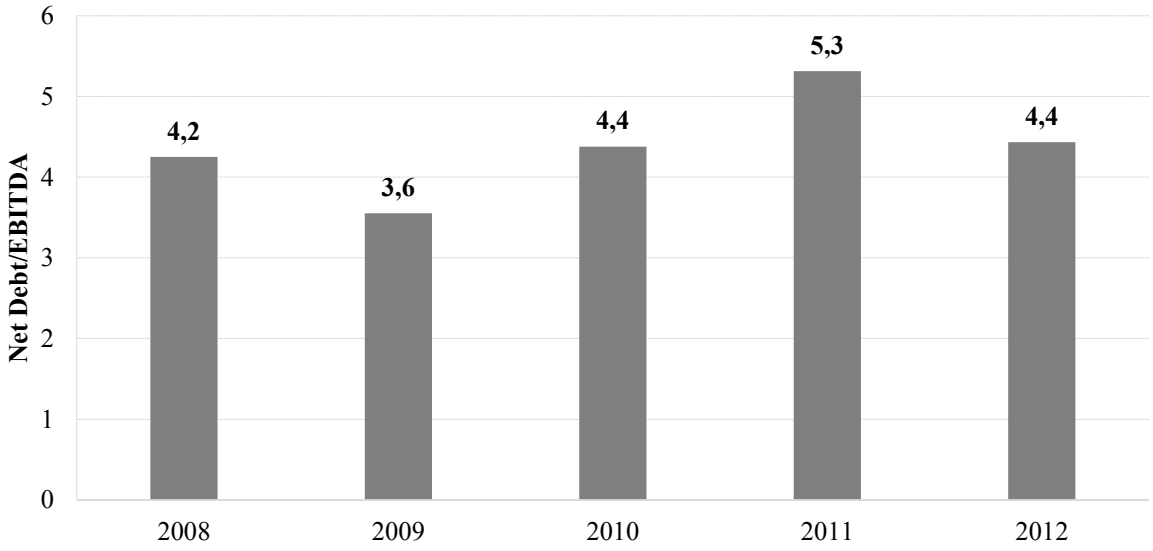
The year-end cash balance of 1,823 MSEK would cover Ratos on-going operational costs of ~200 MSEK[18] and its upcoming dividend payment of 972 MSEK by a fairly wide margin. But there would not be much leeway left to make additional cash-injections[19], add-on acquisitions in portfolio companies, or acquire new companies. *"Ratos needed funding; otherwise the business would have halted. With a pro-longed downturn, they wouldn't be able to pay out dividends or pay back its revolving credit, only the electricity bill. In 2011 and 2012 we didn't know that we would see the growth returning to the Eurozone late in 2013"* (David Halldén, 25.4.2014). At the time of the AGM, Ratos had committed to acquire Aibel and Nebula, and the HENT-deal was likely in the pipeline. Hence, Ratos would still need supplementary funds to pay the outstanding residual on its acquisitions, despite the cut in dividends.

Apart from a reduction in dividend, Ratos could raise the liquidity necessary through an exit. But as Christian Hellman explains: *"It would have been foolish to do an exit only to free-up cash in a bad transaction market. […] Ratos strength as a private equity firm is that they aren't constrained by any definite exit horizons. If an exit from a portfolio company was the only feasible option to generate sufficient internal funds, it was probably better to raise the capital in any another way."* Another option to internally generate funds was to lever up the portfolio companies, and pay out a special dividend to the parent. However, given the current debt levels in the portfolio companies, this was not a feasible option: *"They pay themselves a special dividend once in a while. […] But, the portfolio companies are so highly levered, and under so much pressure… they break debt covenants every month. And in the aftermath of the financial crisis, the banks held credit even tighter. There wasn't much room*

[18] Based on the last years' operational expenses (Ratos, 2012)
[19] See Appendix C, Table C3 for a detailed overview of Ratos' cash injections in portfolio companies

to play around with leverage. Ratos had utilized much of the debt capacity in the portfolio companies already. Theoretically, they could have levered up to the absolute maximum, but if there had been a crisis in Asia or a currency shock, they wouldn't last." (David Halldén, 25.4.2014) Overall, Ratos tends to lever its portfolio companies at x4 EBITDA. This is aggressive leverage compared to public companies, but far less aggressive compared to debt levels in private equity buyouts, fluctuating around x5-7 EBITDA over the last decade (Mergermarket, 2012). *"With x4 EBITDA in the stock market you are essentially a junk bond, but leverage is also very industry specific. Investor bought out Mölnlycke with net debt x16 EBITDA. But Mölnlycke sells patches, that business is as non-cyclical as it gets. Ratos portfolio is highly cyclical and banks aren't as willing to lend to those companies in tough times. […] When Arne Karlsson said: 'We break covenants every month' [at the AGM 2011], the room went dead silent. Of course they want to portray themselves as careful, but careful in relation to what and whom? They do as much as they can"* (David Halldén, 25.4.2014). Investor II confirms the view of Ratos portfolio companies as highly levered: *"Oh, it [the leverage in portfolio companies] is high! It was x4 EBITDA when we looked at it back in May 2013."*

Figure 9
Average Net Debt/EBITDA in portfolio companies



5.2.2 Debt

Ratos has a stated no-debt policy in the parent company, which implies that Ratos should normally be debt-free. All borrowing should be done directly in each portfolio company. If debt is issued in the parent, it should preferably be senior bank debt and no debt syndicates (Ratos, 2013). Moreover, Ratos has a five-year revolving credit facility of 3.2 billion SEK, including an overdraft facility. The purpose of the facility is bridge financing for acquisitions, and to temporarily fund dividends and operational costs in periods with few or no exits. At the end of 2012, Ratos had no long-term, interest-bearing bank debt outstanding, and had not utilized any of its revolving credit facility (Ratos, 2012). With its stable ownership structure, Swedish blue-chip status and 60 years in the stock market, Ratos has strong and long-lasting relationships with the Nordic bank sector. Ignoring the no-debt policy, all analysts interviewed agree that Ratos would be able to secure bank financing with a favorable interest rate.

"*Cheap funding was not the reason they issued preferred stock"* (Christian Hellman, 11.4.2014). Another alternative in the debt sphere was to issue a corporate bond. Given Ratos' household name and blue-chip status, a bond would probably have been well received in the market.

5.2.2.1 Investigating the no-debt policy

Ratos is classified as an investment company and taxed accordingly (Ratos, 2013).[20] This implies that Ratos is normally exempt from any income taxes, and hence, Ratos won't achieve any tax benefits of debt. However, Bo Jungner insists that even if there were any tax benefits of debt in the parent company, Ratos would still remain debt free. *"The no-debt policy has more to do with our fundamental strategy, which rests on the ability to be a strong long-term owner, rather than the tax aspect"* (Bo Jungner, 4.3.2014)

As cash injections are often required in portfolio companies during the course of ownership, the cost of financial distress in Ratos is very high. In the event of financial distress, Ratos face the risk of being unable to optimally support and run portfolio companies, which would result in both direct and indirect losses. Moreover, Ratos' cost of financial distress could potentially be higher compared to unlisted private equity funds. Bankrupting a portfolio company would be extremely damaging to Ratos' image and could severely hurt its relations with stakeholders, both financial and non-financial (Graham and Leary, 2011). Financial stakeholders include Ratos' shareholders and creditors in portfolio companies, mainly Nordic banks. Non-financial stakeholders include employees, customers and suppliers in portfolio companies, Ratos' employees and management, and prospective targets. *"Ratos would never put a portfolio company up for bankruptcy. And that's a double-edged sword for Ratos. It might be useful in negotiations, and enable them to acquire companies relatively cheaper than competing funds and companies, e.g. family-owned companies where the company has sentimental value and the family wants to see their legacy continued. However, when things go bad it's a weakness, because it's so expensive to keep companies with negative equity values alive. Take Jøtul, it must have cost them a fortune by now…"* (Elias Porse, 25.3.2014). Conversely, a private equity fund might decide to cut its losses in a company with assets underwater and hand over the keys to the bank. But why should bankrupting a company be more critical to Ratos, than to any other private equity fund? Private equity companies are continuously evaluated based on their past performance and their capability of raising new funds is also dependent on their ability to generate a sufficient return on investment to its investors. Furthermore, banking relationships are alpha and omega in an industry where one of the ground pillars of the business model is financial engineering through high leverage: *"Of course other private equity companies also get a hard time for bankrupting companies. The banks know what's going on, and in the long run they punish them with more expensive loans. So even smaller market participants pay the price if they resort to liquidation of portfolio companies, but there will be fewer headlines in the press for smaller players"* (Christian Hellman, 11.4.2014).

Pure investment companies, e.g. Investor, Industrivärden and Kinnevik, generally have stable and predictable cash flows arising from dividends from portfolio companies. The reoccurring and predictable cash flows enable them to take on debt in the parent if necessary. Ratos' cash flow from operations mainly arises from exits and profit sharing in portfolio companies. Compared to investment companies, Ratos' cash flows are far more unpredictable,

[20] See Appendix F, Text F1, for excerpt from annual report in original language

as it receives no regular dividends from its portfolio companies. *"We don't maximize, I would rather say that we optimize, debt levels in the portfolio companies. But they are all quite heavily leveraged, and hence don't have much free cash flow distributable to its owners, i.e. Ratos, on a regular basis"* (Bo Jungner, 4.3.2014). Cash flows from exits are exposed to the state of the transaction markets, while cash flows from profit sharing are exposed to the underlying cyclicality of the portfolio. Ratos portfolio mainly consists of companies within industries exposed to the real economic cycle, such as industrials, oil and gas, and consumer goods, and the portfolio composition further enhances the cyclicality of Ratos' cash flows. Table 4 shows the composition of Ratos' portfolio companies based on industry. Moreover, the low sector diversification suggests potential correlation between distressed companies in need of additional cash injections and restructured operations in declining markets. *"In a declining market, a high beta portfolio is painful. You don't get anything out. In a recovery there is nothing better than a high beta portfolio. When the cycle turns you get a double rebound, both exits* ***and*** *profit sharing gains. […] Ratos could have built their portfolio differently in 2006 – 2007. But that was also the time when Sandvik's CEO uttered his famous last words: 'The market is no longer cyclical, it's a super cycle!' And it all went downhill from there…"* (David Halldén, 25.4.2014).

Table 4
Current portfolio composition

Industry	No. of companies	% of total
Industrials	5	28%
Oil & Gas	2	11%
Consumer Goods	7	39%
Business Services	3	17%
Life Science	1	6%
Total	18	100%

With debt in the parent, Ratos could become unable to service interest and principal payments in declining markets and ultimately enter financial distress, given the cyclicality and irregularity of cash flows from operations. The increased financial risk would also increase the probability of a fire sale of portfolio companies under unfavorable market conditions. Moreover, Ratos needs the financial flexibility necessary to acquire targets and optimally support its current portfolio companies. *"Imagine there is a new recession, and banks further restrict their lending. With a debt burden in the parent company, we could potentially go bankrupt since we do not have a business that provides us with a continuous cash flow. In order to be a long-term owner, we must maintain a strong capital base in the parent company"* (Bo Jungner, 4.3.2014). Hence, the overall conclusion is that Ratos is incapable of supporting long-term debt in the parent's capital structure. Analysts tend to share this view: *"I think it's very good that they have a policy limiting long-term debt in the parent company. It reduces the financial risk, and hence the risk that Ratos itself end up in financial distress. Rather you isolate the potential problems in the portfolio companies, and by keeping any fire isolated, you avoid a total breakdown"* (Christian Hellman, 11.4.2014)

5.2.3 Common stock

In 2003, Ratos board got a mandate to issue common stock of Series B in order to finance acquisitions – either through cash payments, set off against debt or non-cash payment. The mandate has been renewed at every AGM ever since. Hence, the board could easily have financed the liquidity squeeze without the AGM's approval during the spring 2013. Despite the yearly renewal of the mandate, Ratos had never issued shares for cash before. There had been several issues of Series B, but these were primarily used to finance non-cash (stock-for-stock) settlements in acquisitions, where owners of the target received Ratos-shares as full or partial payment.[21] Furthermore, the mandate had been utilized to issue shares against warrants bought by management and other staff, or to facilitate share repurchases as an alternative to dividends.[22] Both Bo Jungner and Emma Rheborg make it very clear that Ratos would never raise cash to keep it in the 'treasury chest'. This is both due to the signaling effect of raising equity for cash with no immediate deployment, and also due to the fear of *cash drag* in the portfolio. As cash deposits earn low returns, keeping cash automatically decreases the returns of the overall portfolio, which in turn puts downward pressure on the stock price (Cumming, 2012). Rather, Ratos finance each acquisition **after** each deal is signed. "*When we asked for the mandate to issue Series B, we told the institutions that we would not do any issues to put money in the savings account, only to finance acquisitions already signed, partly to get their acceptance and to avoid any criticism"* (Bo Jungner, 4.3.2014). Nevertheless, when contemplating the issue, Ratos had already signed the deal with Aibel. Hence, Ratos would have legitimate reasons to announce a new issue of common stock within the current mandate.

5.2.3.1 Legislative issues

However, Ratos management stresses that a new issue of common stock also generated some legislative concerns. According to the Swedish Companies Act, a new issue of common stock (seasoned equity offering) can either be a straight issue directed to all current shareholders or a directed issue directed to some chosen parties. A straight issue would require Ratos to issue subscription rights to all current shareholders. With a highly dispersed ownership in the Series B, this would imply reaching out to all of its approximately 54,000 shareholders. *"Even aunt Agda with 100 shares will receive a subscription right. That's both expensive and complicated"* (Bo Jungner, 4.3.2014). Ratos considered this both too expensive and time consuming, to go through with. *"The standard is to raise 15 – 20% of your market capitalization in a straight issue. Ratos typically invest in the range of 300 to 1,000 MSEK, and that's quite small amounts compared to Ratos overall size. Moreover, if you raise 400 MSEK, you get very small subscription rights, especially for small-stake retail investors"* (Alexander Ensér, 17.3.2014). Furthermore, shareholders willingness and ability to inject new capital is an important factor when contemplating a straight issue. *"Ratos is not only family owned, but also to a large extent owned by trusts. These trusts make donations to charity and award a number of research scholarships. To put it simply, they have commitments, and that of course becomes a factor when Ratos need financing"* (Alexander Ensér, 17.3.2014).

Swedish companies have avoided directed issues to current shareholders in recent times, due to an unclear interpretation of the Swedish Companies Act, concerning the potential conflict of interest between shareholders. In a directed issue there is always a risk that the remaining shareholders will consider themselves at a disadvantage.

[21] E.g. when acquiring a minority share in Inwido in 2009 or buying out the Remius-family from HL Display in 2010.
[22] See Appendix B, Table B1, for detailed development of Ratos' share capital

This is mainly due to potential value transfer if shares are offered at too favorable price, which could lead to prosecution in accordance with 'Likhetsprincipen'[23] or 'Generalklausulen'[24]. *"It is normal to give 1-3% discount below the market price in these kinds of issues. Is it worth the risk of getting notified, just because some shareholders might consider that we give a too high discount?"* (Bo Jungner, 4.3.2014). Erik Nerep believes the risk of an accusation from shareholders is very small: *"The last time a firm was accused of this in relation to a seasoned equity offering was in year 2000."* Moreover, a recent note issued by the Council on Legislation suggests that the correct interpretation of the current legislation is that directed issues of equity should pose no legal problems to the issuer (Justitiedepartementet, 2013). However, this note was not yet published at the time when Ratos considered the new issue.

A directed issue to new investors, as opposed to one directed to current stockholders, did not comprehend the same risk. Thus, if Ratos searched for a way to direct an issue of common shares they could have issued shares to new investors. However, Bo Jungner argues that an issue directed to new investors would be infeasible: "Y*ou have to go to the brand new investors, and we have very many shareholders in Sweden, so it would be difficult for us [to raise the capital needed among a totally new investor base]."* Moreover, Bo Jungner points out that Ratos still runs the risk of shareholders opposing the discount on the grounds of value transfers to new shareholders, as it is common practice to give a discount on current market price in all book buildings, regardless of type of issuance. However, Erik Nerep refutes this concern: "*It is perfectly acceptable. … Of course, even such a decision can be criticized for diluting the value of the shares. But it's very rare"*

5.2.3.2 Valuation[25]

Communication is very important to Ratos, in order to provide the markets with the best possible information to accurately value the stock: *"We say everything as it is and present it in a straightforward and honest way. We publish the full results, cash flows and balance sheets from our holdings so that analysts can follow and form their own opinion"* (Emma Rheborg, 25.3.2014). Christian Hellman confirms: *"Ratos is very good at giving information compared with other companies. They even communicate the purchase prices in press releases. It is unique."*

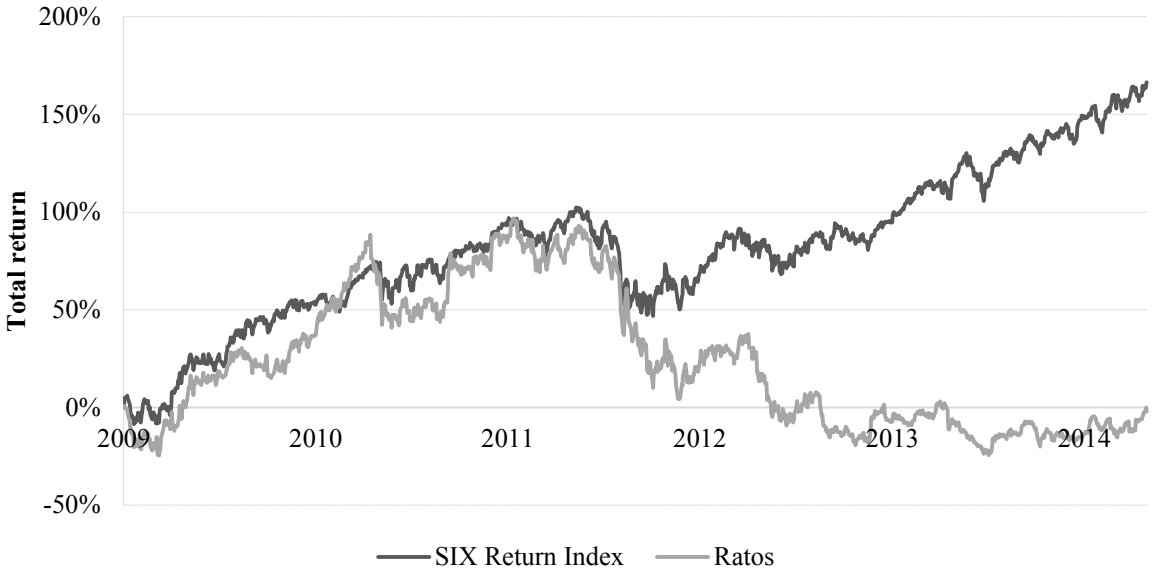
Nevertheless, Ratos' highly dispersed analyst recommendations indicate high asymmetric information in the common stock. Amongst Swedish analyst, the valuation of Ratos varies from a 40% discount to a 70% premium to net asset value, a clear indication that Ratos is a tough company to value.[26]All analysts interviewed base their recommendations on underlying valuations of all current portfolio companies, which requires careful assessment of future topline growth and margin improvements. The toughest challenge however, is to estimate forthcoming entries and exits. Bo Jungner states that this is one of the fundamental problems with valuing Ratos, which makes all valuations of Ratos somewhat incorrect. Christian Hellman discloses that he values all portfolio companies as going concern, if nothing else is clearly communicated by Ratos.

Albeit strong on communication, Ratos never discloses its own valuations of its portfolio companies. However, both Bo Jungner and Emma Rheborg hint that they currently view Ratos' common stock as

[23] Swedish Companies Act, Chapter 4 §2. For text in original language see Appendix F, Text F2
[24] Swedish Companies Act, Chapter 4 §47. For text in original language see Appendix F, Text F2
[25] The discussion is only related to the Series B. There is too little trading in the Series A to make any conclusions about its price.
[26] UBS, Swedbank, SHB, Carnegie

underpriced. In December 2012, Ratos traded at 62.5 SEK per share, compared to 124.5 SEK in December 2010. In two years, Ratos had lost 50% of its market value, and significantly underperformed its explicit goal to always provide its shareholders with a return beating the overall stock market.

Figure 10 (Source: Thomson Reuters Datastream)
Return on Series B compared to SIX Return Index



5.3 May 2013: Preferred stock

With limited leeway to cut dividends, a strong wish to keep the parent debt-free, and unfavorable stock price development, Ratos sought out alternative financing. One of the alternatives discussed was preferred stock, and the board viewed this as an interesting opportunity that would address some of the concerns with regard to debt and equity issues. It would add a new tool to Ratos' financing toolbox and enable the board to pick the financing suitable given prevalent market conditions. Oscar Properties and Fast Partner had recently made successful issues, indicating demand for preferred stock. *"I think preferred stock has become increasingly popular for two reasons. Firstly, the Swedish market has become increasingly sophisticated. The market has come to appreciate different types of securities apart from simple corporate bonds and equity. Second, investors are scared after experiencing the turbulent equity markets following the Lehman-crash. They search for relatively high yield, but are unwilling to take on too much equity risk. When the investor's alternative is to buy Volvo, Skanska or Vattenfalls' corporate bonds, companies can exploit the current market situation and issue preferred stock"* (Investor II, 29.4.2014).

However, preferred stock also generated some concerns: *"It was the first time we saw one of the large corporations in Sweden doing this"* (Alexander Ensér, 17.3.2014). Consequently, both management and the financial advisors were uncertain about the market reception. Furthermore, while preferred stock issues had a successful track record within the real estate sector, Ratos lacked the regular cash flows to match the quarterly dividend payments, which left analysts wondering: *"Preferred stock is best suited for companies with stable earnings, otherwise it can get pretty tough. There are quite high interest rate penalties if you don't pay the set dividends. It's suitable for real estate companies, or companies that have*

difficulties obtaining other types of financing. Ratos' issue is unique in the sense that preferred stock doesn't really fit their operations. Their earnings can be very uneven" (Christian Hellman, 11.4.2014). However, as the planned issuance was relatively small compared to the current equity outstanding, the preferred stock dividend was likely not at risk. *"It's a small issue. So given the size, it won't be a problem for Ratos to meet its obligations. But if they do a larger issue later, I don't see it as a match"* (Christian Hellman, 11.4.2014). Furthermore, with the revolving credit facility of 3.2 billion SEK, Ratos would be able to meet its quarterly obligations on the preferred stock, at least in the short run: *"We asked quite bluntly during the investor meeting: 'If you can't cough up the money [to pay the fixed dividend], what will you do?' Susanna [Campbell] answered that they could utilize their credit facility, but she refused to give a 100% commitment. I think they will use the credit facility if necessary, but they made no guarantees"* (Investor II, 29.4.2014).

Ratos sought to have a term sheet ready in time for the notice of the AGM 2013, which would take place in Stockholm Concert Hall on April 17th. The proposal of the new series preferred stock was anchored with the largest shareholders in advance. Subsequently, the meeting voted in favor of the board's proposal, with a qualified majority of 2/3 of the votes and shares present at the AGM (Ratos, 2013d). The AGM thereby authorized the board to issue a maximum of 1,250,000 preferred shares in connection with acquisitions. The subscription price would be determined in accordance with market conditions prevalent at the time of issuance. A month later, at May 27th, the board decided to issue 830,000 shares of Series C. In the following press release, Ratos communicated that the issue was aimed to fully finance the acquisitions of Nebula and HENT, and the partial acquisition of Aibel. However, analysts did not view the preferred stock issue as specific acquisition financing. The size of the issue gross of fees was hardly enough to cover the recent dividend payments to common stockholders and the upcoming quarterly dividends on the preferred. "*They say it's for investments, and not for paying dividends or bills. But in the end it's all drawn from the same liquidity pool. They needed cash"* (David Halldén, 25.4.2014).

5.3.1 The prospectus and terms

Ratos released the prospectus on May 28th. It was directed both to institutional and retail investor, and included 830,000 preference shares of Series C at a subscription price of SEK 1,750 per share. A fully subscribed issue would provide Ratos with a total of 1,425.5 MSEK before any transaction costs. The suggested dividend, redemption rate and voting rights per share were already set in the proposal presented to shareholders at the AGM. The offering price was set subsequently to the board's decision to issue Series C. This is the common approach to price a new issue. The management and advisory team decide on an appropriate dividend, and the price is subsequently set during book building of the prospectus, which in turn determines the dividend yield.

The dividend was set at 100 SEK per year, cumulative and paid quarterly. Following the AGM in 2017, the dividend increases to 120 SEK per year. If Ratos fails to pay out the full dividend, the corresponding amount remains outstanding, and is subject to an interest rate of 10%. Redemption can take place at 115% of the subscription price until the AGM in 2017. Following the AGM in 2017, the redemption premium decreases, and redemption can take place at 105% of the subscription price. Redemption includes any potential dividends outstanding. Only Ratos, not the investors, can initiate redemption. In the event of liquidation the preference

shares have priority over shares of Series A and B at redemption value, including any dividends outstanding (Ratos, 2013b). According to Swedish Companies Act, a company is allowed to differentiate voting rights between its different classes of shares maximum ten times[27]. Series A has one vote per share, while Series B has one-tenth vote per share. Consequently, the minimum voting right assigned to Series C was one-tenth vote per share, corresponding to the voting rights in Series B. From a common shareholder perspective, equal voting rights for preferred and common stock might seem unfair, as preferred shareholders are not equally exposed to the underlying risk of Ratos' business. A solution is to issue the preferred stock in larger units than the common, offering preferred shareholders less voting power in proportion to the capital invested.

Ratos included a redemption clause with very specific limits: *"After four years the dividend increases, while the redemption rate decreases. It clearly signals to investors that we see this as a four-year loan, with a high probability that we'll refinance after four years"* (Bo Jungner, 4.3.2014). This was mainly to ensure that the market would recognize Ratos' intention to refinance after four years. But investors were also given a slight potential for capital gains, as the shares had a slightly wider range to trade in within the first four years. Issuing a convertible, rather than a straight preferred was never an alternative to Ratos, according to Bo Jungner. Partly because they wanted to buy back the preferred stock outstanding, and partly due to a clientele effect: *"If you have the opportunity to convert, some investors will not invest. Fixed income investors don't want to end up with common shares and equity risk"* (Bo Jungner, 4.3.2014).

While a company seldom sets a finite price prior to book building, the company can relate the set dividend to a range of prices, and hence choose a price range corresponding to a suitable dividend yield. *"In that way, you choose the dividend after what price you want to achieve"* (Alexander Ensér, 17.3.2014). With a dividend of 100 SEK per share, the price range of 2000 – 1000 SEK would result in a dividend yield in the range of 5-10%. A relatively high price limited the preferred shareholders' voting rights and constrained the number of new shareholders in Ratos. On the other hand, a too high price could potentially harm the liquidity in the stock, and also risk individual retail investors' ability to invest. The advisory team approached several institutional investors to determine an appropriate offering price. The offering price can either be fixed or indicated by an interval. As the issue targeted both institutional and retail investors, Ratos deemed a fixed price more suitable. *"Institutions are accustomed to price ranges, but private investors might find it too complex"* (Bo Jungner, 4.3.2014). Alexander Ensér explains that the pricing of straight redeemable preferred is less sensitive than the pricing of common stock, as the redemption rate puts an upper bound on the price at which redemption will take place. *"If you set the price at either 1750 SEK or 1800 SEK, it is nothing like issuing common shares at plus-minus 50 SEK. You can still buy back the instrument at a rate related to the issue price. Sure, the price does matter, but mainly because it affects the yield. However, the difference in yield would be small too. While a price of SEK 1800 corresponds to a yield of 5.6%, a price of SEK 1750 yields 5.7%."* (Alexander Ensér, 17.3.2014)

Both investors interviewed believe that Ratos deliberately chose a low offering price. The relatively small market for preferred stock in Sweden, and the uncertainty with regard to the market reception might have tempted the management and the advisory team to issue the preferred stock relatively cheap. As underpricing offers higher yield to investors, and hence increase the cost of financing, it is done at the expense of common shareholders.

[27] Swedish Companies Act, Chapter 4, § 5. For text in original language see Appendix F, Text F2

However, the momentum and goodwill created might be profitable for the common shareholders in the long run. Furthermore, current shareholders had priority in the distribution of new shares, offering them the benefits of a low priced offering. *"Ratos could probably issue, and get full subscription, at a lower yield, e.g. 50 basis points. However, a low price was a great way to create a momentum in the stock and to compensate current shareholders for the prior bad performance of the common stock. If Ratos do another preferred stock issue, they will probably have a lot of goodwill in the market"* (Investor II, 29.4.2014).

Ratos ultimately set a price of 1,750 SEK per share, corresponding to a dividend yield of 5.7%. *"If they have preferred stock that costs them 6%... They might have been able to borrow cheaper. If they had issued a bond or a convertible, maybe?"* (Elias Porse, 25.3.2014). Hence, the preferred stock was relatively expensive financing compared to a bond, even without Ratos' ability to achieve tax deductibility of interests. However, the dividend yield at issuance was 5.7%, only 1%-point higher than the dividend yield of the common stock, which was 4.7% at settlement day (April 22nd 2013). *"We did the deal because we invest in credit instruments. But, there was still good yield on the common stock, even after the dividend cut. And that poses an interesting question: Should you buy the common or the preferred? If you believe in Ratos as a company, you should buy the common"* (Investor II, 29.4.2014). A back-on-the-envelope calculation illustrates that if Ratos continued to yield 20% on its portfolio, common shareholders would still receive 20% - 5.7% = 14.3% in return on equity after preferred shareholders were paid off. But was a 20% IRR still feasible for Ratos over the next few years? On average, the last years' exits had underperformed the target, and if this turned out not to be just a temporary dip, the preferred stock might turn out to be a very expensive financing alternative compared to a bond or a bank loan.

5.3.2 Market reception

The application period for Series C opened May 29th for institutional and retail investors. The prospectus was well received in the market and oversubscribed several times (Ratos, 2013c). Given the high demand, Ratos shortened the application period for institutional investors with nine days. The investors claim that the positive market reception was expected, rather than unexpected. *"Ratos' is a household name in Sweden, attracting investors from both the credit and the equity segment. The credit segment was (is) desperately seeking yield, while the equity segment is loyal to the Söderbergs. I am surprised they haven't issued another series of preferred stock already"* (Investor II, 29.4.2014). At settlement day, June 19th, approximately 6,000 investors were assigned preferred stock. The investor base was somewhat different compared to previous preferred stock issues in the market: *"You usually see the private banking segment, both high-wealth individuals and funds investing on behalf of private banking programs, investing in preferred stock. Ratos was the first issue where institutional investors subscribed to more than half the book. 58% of investors were institutional, the remaining 42% was allocated to retail investors"* (Alexander Ensér, 17.3.2014).[28] Current shareholders and customers of Ratos' financial advisors had priority in the allocation of shares. Existing shareholders who did not participate in the issue experienced a dilution of 0.3% on their shares.

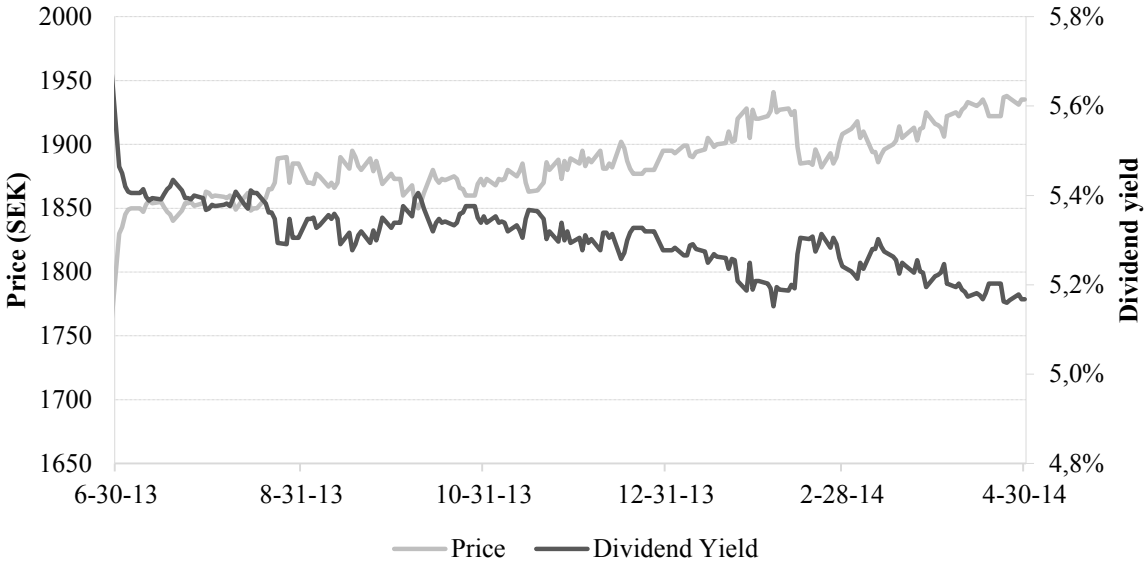
[28] See Appendix A, Table A3, for a detailed view of listed investors participating in the issue

Table 5
Dilution of common shareholders

	Before issuance	Series C	New total	Dilution
Shares	324 140 896	830 000	324 970 896	0.3%
Votes	108 587 444	83 000	108 670 444	0.1%

Like Ratos' common stock, the preferred stock was listed at Nasdaq OMX Stockholm, with first day of trading at June 28th. The stock closed at 1,830 SEK, corresponding to a 4.6% appreciation during the first trading day. After only three days of trading, the stock traded at 1,845 SEK, above the redemption price in 2017. Both Investor I and II expected an immediate appreciation in price, and corresponding depreciation in dividend yield. Investor I represents an actively managed equity fund. The fund bought the preferred stock and sold it off roughly two months later when the pre-anticipated yield was met. Investor II represents a privately held investment company focusing on credit instruments. They initially intended to hold the stock until redemption. However, the fund sold out early, as corrections in the European credit markets enabled even better investment opportunities at the time. *"Even when the rest of the European market traded down, Ratos preferred stock continued to appreciate. There was an incredible interest in the stock"* (Investor II, 29.4.2014). Investor II stresses that their positive view on the security did not change during the course of ownership, and the markets seem to share the investors' point of view. Figure 11 shows the price and dividend yield development of Ratos' preferred stock since issuance.

Figure 11 (Source: Thomson Reuters Datastream)
Stock price and dividend yield development of Series C



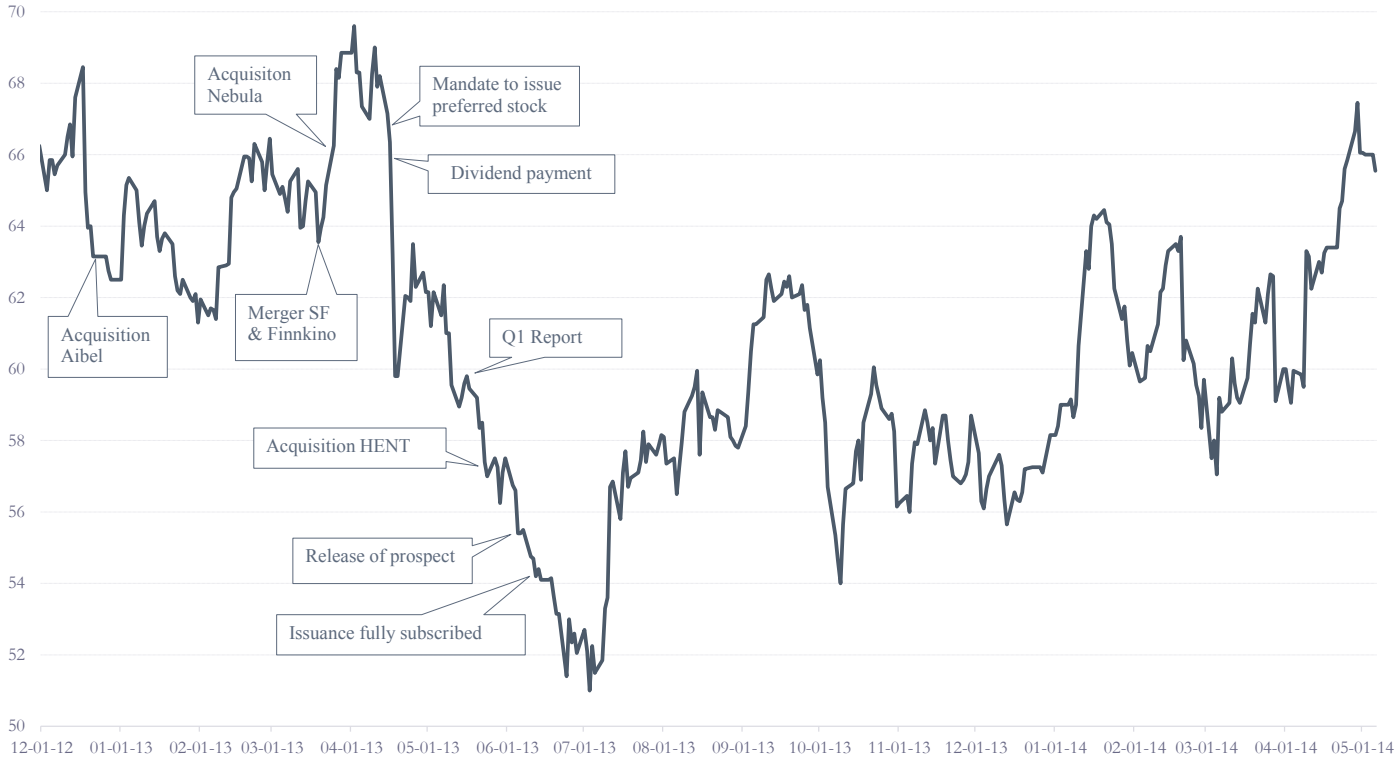
As of 30.4.2014, Ratos' preferred stock traded at 1,934 SEK, with a dividend yield of 5.2%. Under the assumption that Ratos will redeem the shares at 105% in 2017, investors buying Series C above 1,750 x 1.05 = 1,837.5 SEK will realize a capital loss if held to redemption. *"If you can get 1% on your savings account, then it's still better to get 4% on your investment. […] Of course, 5.7% would have been better, but what can you do?"* (Bo Jungner, 4.3.2014). Investor II attributes Ratos' low dividend yield to its blue-chip status and household name in Swedish financial markets: *"This is the only blue chip company, so far, issuing a preferred stock instrument. And then there is the whole aura surrounding Ratos, Arne Karlsson and the Söderberg-family"* (Investor II, 29.4.2014). Moreover, Ratos clearly communicates its intentions to buy back the stock, and include a dividend-step up that mitigates some of the interest rate risk: "*During the first four years the redemption rate is 115%. It's too expensive; we would never do that [buy back the shares before 2017]. […] And after four years the fixed dividend increases, while the redemption rate decreases. We think it sends a clear signal to the market: 'We see this as a loan with a four-year maturity' "* (Bo Jungner, 4.3.2014). In comparison to preferred stocks without any clear redemption date and dividend step-up, Ratos' preferred stock has less exposure to interest rate risk, which might explain the low yield.

5.3.3 Common stock reaction

Following the AGM and the subsequent dividend payment in April, the common stock fell almost 10 SEK per share. It is common to see a negative ex-dividend reaction in the interval between dividend settlement and payment, when the stock trades without dividend rights (Berk et al., 2011). However, Ratos' stock fell far more than the dividend of 3 SEK per share. *"Ratos is a stable dividend payer, and hence the common stock tend to appreciate prior to, and depreciate following, the dividend settlement date. It's a natural consequence of the endowments timing their purchases to dividend payments, jumping from stock to stock"* (Emma Rheborg, 25.3.2014). The common stock subsequently made a

quick rebound, before falling again upon the release of the quarterly report (Q1 2013) in May. Figure 12 depicts the common stock price development from December 2012 and onwards.

Figure 12 (Source: Thomson Reuters Datastream)
Price of Series B

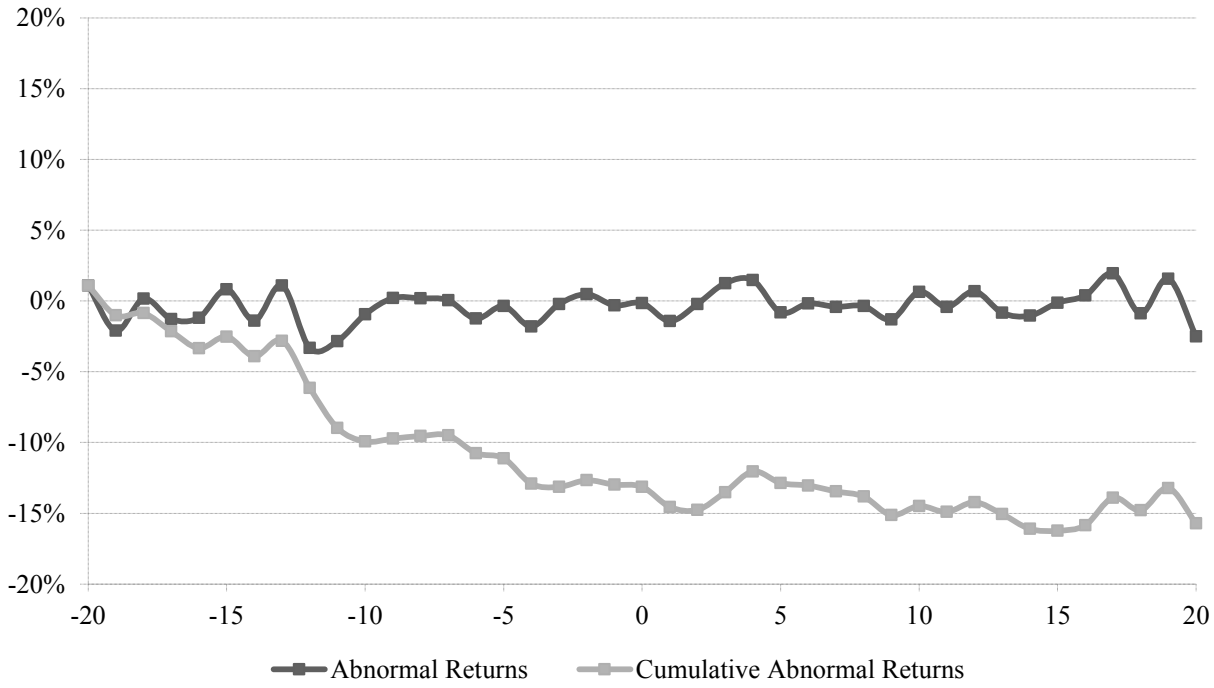


Both Linn and Pinegar (1988) and Kallberg et al. (2013) identify negative announcement returns to common stock following issues of preferred stock. This supports a signaling story where a preferred stock issue conveys new and negative information, either because the company rarely issues hybrid securities, or because lack of transparency makes the issuance motives unclear. Furthermore, Kallberg et al. (2013) find that the negative effect decreases with increasing creditworthiness. This suggests that the markets link financial distress to preferred stock issuance in accordance with the financial distress hypothesis put forward by Moyer et al. (1987) and Donaldson (1962). Figure 13 provides a brief summary of the announcement returns to Ratos' common stock Series B.

Figure 13
Event study: Common stock announcement return

We conduct an event study of the possible announcement effect to common stock returns (Series B) based on the methodology of MacKinlay (1997). We calculate the abnormal returns using the market adjustment model[29], $AR_{i,\tau} = R_{i,\tau} - R_{m,t}$, where $AR_{i\tau}$ is the abnormal return of company *i* at time τ. $R_{i,\tau}$ is the observed return of company *i* at time τ and $R_{m,\tau}$ is the expected return of company *i* at time τ given by the market index. We use SIX Return Index as the benchmark market index to calculate expected returns. The event is defined as the announcement date of the prospectus, May 27th 2013, and estimate abnormal returns (AR) and cumulative abnormal returns (CAR) over two event windows: -20 to +20 days from announcement to -1 to +1 day from announcement. CAR (-20,20) is statistically significant on a 1% level for a two-sided test with a t-test of -13.99, while CAR (-1,1) is not statistically significant, with a t-statistic of -1.77 (See Appendix E). One day after announcement (+1) we observe an abnormal return of -1.42%, however not statistically significant, with a t-statistic of -1.06. Given the small sample size, we bootstrap the distribution of AR (200 replications) and compute the bootstrapped standard error, to reduce the probability of a Type II-error. With bootstrapping the observed AR at day +1 is statistically significant at a 1% level for a two-sided t-test, with a t-statistic of -12.3 (See Appendix E).

Abnormal Returns and Cumulative Abnormal Returns (-20, 20)



[29] The literature on event studies suggests little improvements from more complex calibration of expected returns, such as the 'normal market model' or the 'Fama French three factor model' in studies covering short-term (less than one year) time horizons. A more detailed discussion of this beyond the scope of our thesis, see MacKinlay (1997), Fama (1976), Fama et al. (1969) for further references.

The economically and statistically significant stock price reaction found in the 40-day window around announcement is mainly driven by the negative abnormal returns prior to announcement. However, a number of events leading up to the announcement day might also have a significant impact on the common stock price, such as the release of the Q1 2013 on May 15th 2013 and the acquisition of HENT on May 24th 2013. "*They merged SF with Finnkino, bought out Nebula in Finland and HENT in Norway. And then Aibel… There was a lot going on at the same time, not just the preferred stock"* (Elias Porse, 25.3.2014). Moreover, it is not unlikely that the markets already incorporated any views on the preferred stock issue when the proposal was described in the shareholders' notice of the AGM 2013, or when the board received the mandate to issue in April 2013. Ratos' management suggests that there were no immediate plans to issue the preferred stock following the mandate. However, analysts view this differently: *"That sounds like a cover. Of course they intended to issue. My interpretation is that it was a little bit too hectic, with Aibel and the dividend payment and… A lot of cash was leaving the company at the same time"* (Christian Hellman, 11.4.2014). While Elias Porse expected a negative impact on the common stock, as *"…it's expensive financing compared to bank loans",* Alexander Ensér believes the issue should be good news to the common stockholders. However, he does not see it as a compelling case to analyze the common stock price based on the issue alone: "*If the common shareholders believe Ratos will return 20% on its portfolio, the preferred stock is cheap financing, and hence the reaction should be positive. It's a matter of risk and reward. In this case they might have traded off some reward for lower risk. But I don't believe it's possible to identify the stand-alone effect of a preferred stock issue. It's hard to dissect stock performance and isolate effects of the different stock value drivers. Ratos is highly exposed to European markets, and have a very cyclical portfolio, so I think their common stock is mostly affected by the state of the real economic cycle and performance of the portfolio companies"* (Alexander Ensér, 17.3.2014).

5.3.4 Epilogue

Following the successful issue and trading of the Series C, the board proposed a mandate to issue a Series D at the AGM in May 2014 (Ratos, 2013). The new series holds the same overall features as Series C, with three exceptions. Firstly, the dividend step-up and decrease in redemption rate are delayed one year, to 2018. *"If we'd do an issue very soon, we'd probably issue Series C to increase the liquidity in the stock. But at the end of 2014, the shares will have such a short lifetime, given the dividend step-up and redemption rate decrease in 2017"* (Emma Rheborg, 25.3.2014). Second, the redemption rate is reduced from 105% for Series C to 100% for Series D, and lastly, the dividend step-up increases from 120 SEK to 128 SEK per year. *"In our experience, investors had a hard time valuing the 5% redemption premium. As we are the ones to initiate redemption, they were uncertain as to when it would really happen and hence at what rate. The lack of redemption premium is an even stronger signal that we intend to buy back the shares when the dividend step-up kicks in"* (Bo Jungner, 4.3.2014). The lack of premium on face value makes the Series D even more similar to a coupon bond, and hence easier to value. The design of Series D is meant to send an even stronger signal to investors that Ratos intend to redeem the preferred stock series after four years. *"We don't want to have several hundred million SEK in preferred stock outstanding without the option to redeem. It's a small market after all, so the liquidity of the stock might become a problem, and moreover they have substantial placement risk if interest rates increase"* (Bo Jungner, 4.3.2014).

6. Discussion

The following section discusses the number of factors that might have influenced Ratos' decision to issue preferred stock, and conversely, the decision not to issue equity or debt. These factors are both company-specific; such as Ratos' ownership structure, payout policy and no-debt policy; and market-specific, such as the weak exit markets and heated fixed income markets at the time.

6.1 Ownership structure

Most interviewees assign a high, albeit non-monetary, value to the family control by the Söderbergs:

> *"The Söderbergs holds 40% of the capital and 70% of the votes, and they understand the underlying strategy and cyclicality of the private equity industry very well. The larger, institutional shareholders are also well informed owners."* (Bo Jungner, 4.3.2014)

> *"I believe everyone is content with the ownership structure – it is a well-reputed family and good owners, which ensures stability. But ownership structure is more of a soft-factor, we don't even try to estimate a minority discount on the Series B."* (Christian Hellman, 11.4.2014)

La Porta et al. (1999) suggest that one of the main reasons to retain family control is the desire to avoid uniformed outside stockholders interference. Outside intervention from activist shareholders could shift Ratos' strategic focus from long-term performance of the portfolio to short-term performance in the stock market. Furthermore, shifting blocks of shareholders with opposing views of how to handle acquisitions, restructurings and divestments might hamper the successful execution of Ratos' strategy, and could potentially compromise Ratos' strategic objectives to a long-term, active owner with focus on operational improvements. Moreover, smaller investors might lack both the skill and the time necessary to optimize Ratos portfolio, and the underlying operations in its portfolio companies.

The Söderbergs' controlling stake does not appear at risk given the little observed trading in the Series A, the highly dispersed minority ownership, and the friendly relationship between the minority and the controlling block of shareholders. However, it is likely to assume that both management and the Söderbergs would prefer to avoid any dilution of control. The lack of tension between minority and controlling shareholders is likely attributable to Ratos' historical performance prior to 2010, with high dividend payments and favorable stock price development. Given the recent years' less favorable development, the minority shareholders might start to question the controlling stake's impact on Ratos' operations, and increase their efforts to monitor the management and the board's decision making.

Mishra and McConaughy (1999) and McConaughy et al. (2001) investigate the relationship between family control and capital structure, and find that companies controlled by a (founding) family hold less debt than comparable companies. *"The family is of course very keen to defend their majority ownership. If you take up debt in the parent, maybe you'll have to do a new issue in the event of a crisis. To minimize the risk of that, it might be wise to keep the parent healthy"*

(Christian Hellman, 11.4.2014). Debt increases the financial risk of the company, and the risk of financial distress. In the case of financial distress, the capital structure is often restructured by conversion from debt to equity, or a new issue of equity. Hence, Ratos might have favored preferred stock to debt in the parent to avoid a potential dilution in the case of financial distress. The same logic applies to a new issue of equity, which would imply an immediate dilution of control. Ratos preferred stock holds equal voting rights to its common stock Series B. However, the voting rights in proportion of capital invested are far smaller. To raise 1,425 MSEK through a new issue of common stock, Ratos would need to issue approximately 24 million shares[30] of Series B, compared to 830,000 shares of Series C. This would imply a dilution of 7.1% on the total number of shares, and a 2.1% dilution of voting rights. In comparison, the preferred stock issue diluted the shares by 0.3% and the voting rights by 0.1% to the owners not participating in the offering. Hence, the preferred stock issue avoided any significant dilution of control that might arise from a common stock issue, or a conversion from debt to equity in the event of financial restructuring.

Given the non-convertibility, fixed dividend and clear signal of redemption after four years, the preferred stock has the unmistakable properties of a corporate bond with a four-year maturity. Axelson et al. (2009) propose a model where the need to raise external debt in order to finance investments discipline managers and prevents overinvestment, as creditors can refuse to finance. Historically, Ratos' acquisitions have either been financed with internal funds or stock-for-stock settlements. Furthermore, the family control implies that minority investors' ability to influence Ratos' investment decisions is effectively zero. Hence, Ratos had close to permanent financing prior to the issuance. As the preferred stock is meant to be non-permanent and refinanced after four years, the issue might be viewed as delegating more control to minority investors, in line with Axelson et al. (2009). However, in comparison with bonds or bank loans with defined maturities, there is no absolute need of refinancing in the preferred stock, as Ratos can leave them outstanding at the cost of the dividend step-up. Bo Jungner confirms that there is a possibility, albeit small, that Ratos will leave the current shares outstanding: "*The dividend step-up is not too high [in Series C], so it is not that expensive to keep the preferred stock outstanding. But most likely we will redeem the shares after four years."* Nevertheless, Bo Jungner also confirms that it is very likely that Ratos will choose to issue a new series of preferred stock in the near future: *"Given the likelihood that market conditions have changed, we might issue a new series of preferred [with updated terms] if we do any new acquisitions. We see it as a kind-of rolling issue so to speak."* Hence, the increased control is not exclusively dependent on the notion that Ratos would repurchase after four years, but rather that they will issue subsequent series of preferred stock in the future. Thus, minority investors have the opportunity to evaluate acquisitions on a deal-by-deal basis, and subscribe to a new issue or leave it at the table, depending on their assessment of the offer and the deals Ratos intend to finance.

6.2 Dividends

With a history of stable and high dividend payments, Ratos stock is widely regarded as a dividend stock in the market. *"He [Arne Karlsson] repeatedly mentioned that the dividend was a key attraction to Ratos"* (David Halldén, 25.4.2014).

[30] Given the current stock price at May 27th 2013, 57.5 SEK per Series B-share

Modigliani and Miller (1961) suggest that dividend policy should be irrelevant to firm value in perfect capital markets.[31] However, Ratos announcement to cut dividend payments made the financial markets uneasy. *"We expected, like consensus, a reduction in dividend. But we did not expect the reduction to be that large."* (Markus Iwar at Goldman Sachs to Dagens Industri, 2012). Upon the announcement to acquire Aibel and reduce the dividend to 3 SEK per share, the common stock lost 7% of its market value during the subsequent trading day.

The *pecking order theory* predicts that the preferences for internal funds should lead managers to adjust their payout policy accordingly, i.e. reduce dividend payments to finance investments. However, dividends tend to be sticky, meaning that payout ratios tend to be only gradually adjusted over time. Miller and Rock (1985) argue that with information asymmetry between managers and investors, dividends convey signaling information about a firm's future earnings power, which explains why managers are reluctant to abruptly reduce dividends. Hence, dividend payments become a proxy for the level of asymmetric information, where higher dividend payments should reduce the information asymmetry in the stock. With a fundamentally high information asymmetry in Ratos' common stock, it is reasonable to believe that dividend payments were used as a tool to reduce asymmetric information and signal information of future earnings power. Despite the cut, Ratos would still pay out more than 100% of its net income in 2012. The consecutive years of dividend payments exceeding the net income, followed by the modest cut, supports the prediction made by Myers and Majluf (1984), that dividends tend to be sticky, and the prediction by Miller and Rock (1985), that reducing dividends signal negative information to investors. *"It is always tough to cut a dividend. But a dividend should reflect the result and no-one wins when a company pays out more dividends than it earns."* (Bo Jungner, 4.3.2014)

An alternative explanation for dividend stickiness is the clientele effect introduced by Modigliani and Miller (1961). The clientele effect suggests that investors buy different stocks given their preferences for dividend versus capital gains yield, and hence Ratos might be reluctant to reduce its dividend payments with the fear of dividend investors abandoning the stock, putting downward pressure on the stock price. Modigliani and Miller (1961) further argue that this is irrational behavior as *"any clientele should be as good as the other",* meaning that a change in debt policy should simply change the investor clientele. In perfect capital markets a change in dividend policy should not affect the firm value, and hence leave the stock price unaffected.

6.3 No-debt policy

The decision to issue preferred stock corresponds well with the previous literature, which finds correlation between low marginal tax rates and the choice to issue preferred stock over debt (Houston and Houston, 1990; Ely et al., 2002). Bo Jungner insists that even if the parent company would pay income taxes, Ratos would remain debt-free. Hence, it appears that the decision to issue preferred stock over debt was unrelated to the lack of interest tax shields. Furthermore, Donaldson (1962) and Moyer et al. (1987) propose a financial distress-hypothesis, where the likelihood of preferred stock issuance increases in financial distress. While Ratos' operational performance and

[31] As the effects of reducing dividends and rely on retained earnings versus increasing dividends and float new shares should cancel each other out in perfect markets

common stock price development was inevitably poor leading up to the issue, we find little evidence supporting a prediction that Ratos was close to enter financial distress.

According to Graham and Harvey's survey (2002), managers are less occupied with the potential cost of financial distress when making debt decisions. However, they appear to be very concerned with credit ratings. Credit ratings are based on assessment of default risk, and hence this is an indication that managers are implicitly concerned with distress when contemplating to issue debt. Ratos' high cost and probability of financial distress predicts an aversion towards debt according to the *trade-off theory*, and might have been a contributing factor to the decision to issue preferred stock. As dividend payments do not constitute a mandatory obligation and hence no event of default, preferred shareholders are unable to force bankruptcy upon Ratos. Hence a preferred stock is a far more forgiving security to have in the capital structure than debt.

Graham and Harvey (2002) also find that managers value financial flexibility, defined as preserved debt capacity, highly when contemplating financing. Ratos repeatedly states their need for financial flexibility in order to utilize opportunities for acquisitions when they arise in the markets. The management argues that Ratos' mandate to issue common stock, the ability to draw on the revolving credit facility and the latest addition to the financing toolbox; the preferred stock, enhances the financial flexibility in the company. *"We increased our financial flexibility considerably through the issuance of preferred stock"* (Susanna Campbell, Annual Report 2013). Moreover, Graham and Harvey (2002) suggest that maintaining financial flexibility is more important to dividend paying companies than non-dividend paying companies. This is somewhat a puzzle, since dividend payments should imply lower asymmetric information and hence less need to maintain financial flexibility, as it should be easier to approach the financial markets to raise capital. Nevertheless, with the preferred stock, Ratos was able to maintain its emergency debt capacity in the form of the revolving credit facility and the opportunity to issue senior bank debt, while staying true to its no-debt policy.

6.4 Common stock price

Given the preference to avoid comments on its specific valuations, Ratos' management refrains from making any explicit comments about the common stock price at the time they considered their financing alternatives. However, they agree that one of the favorable aspects of the preferred stock issue was the ability to avoid taking a stance on the offering price in a new issue. Ratos strongly argues that this was mainly due to legislative concerns arising from the fuzzy interpretation of Swedish Companies Act with regard to directed issues. While the argument is convincing, we find little support amongst business law practitioners that this should be a valid concern.

An alternative explanation could be that Ratos wanted to avoid any negative signaling effect from a new issue. The *pecking order theory* suggests that regardless of previous financing choices, debt is always preferable to equity, due to the high asymmetric information of equity. Assuming managers maximize existing shareholder's value, the manager of an overvalued firm will be happy to sell equity, indicating a value transfer from new to existing shareholders, while the manager of an undervalued firm will prefer internally generated funds or debt, i.e. to avoid the value transfer from existing to new shareholders (Myers and Majluf, 1984). As only the manager knows the true value of the firm's assets and growth opportunities, outside investors can only guess these values,

leading to a pooling equilibrium where companies can only issue equity at a discount, regardless of the true value of their investment opportunities. The fundamentally high information asymmetry, the skepticism towards the acquisition of Aibel, and the following dividend cut, could all pose strong, individual reasons for Ratos to avoid a new issue of common stock under the *pecking order theory*. Hence, an issue of common stock could potentially have large signaling effects, spurring further speculations with regard to Ratos fundamental value. *"With the preferred stock we could set the price independent of our current stock price, much like a bond. We did not have to take a stance to whether we had a proper, high or low stock market valuation."* (Bo Jungner, 4.3.2014).

Graham and Harvey's findings (2002), support the notion that companies are reluctant to issue common stock when management perceives it as undervalued. However, negative signaling concerns do not appear to cause the importance of this factor. Rather management avoids equity because it makes it relatively expensive, e.g. compared to debt, when perceived as undervalued. Hence, Graham and Harvey (2002) interpret their findings as inconsistent with the *pecking order theory,* but consistent with the *market timing theory*. The market timing theory suggests that observed capital structure evolves from companies' past attempts to time capital markets, rather than company-specific factors such as information asymmetry or debt capacity. Managers will issue equity in overheated equity markets, e.g. when equity is relatively cheap, and debt in overheated debt markets, e.g. when the yield is relatively low. Hence, managers seek out markets where the investors do not receive the full dividend and capital gains yield, or interest rate, corresponding to the fundamental underlying risk of the firm. The unfavorable stock price development from 2010 and onwards implies that a new issue of common stock would be expensive financing compared to alternative external sources; e.g. debt and preferred stock. Moreover, a new issue would require a discount on the current market value, probably around 2-3% according to Corwin (2003) and Altinkilic and Hansen (2003). Thus, a third explanation could be that Ratos simply avoided a new issue of common stock due to the poor development of the stock price, regardless of what the management and the board perceived as Ratos fundamental value.

6.5 Weak exit markets

An obvious, but unfavorable, solution to Ratos' financing need would be to exit one or several of the portfolio companies. The exit markets had remained weak since the financial crisis, and portfolio companies bought out on the top of the cycle in 2006 and 2007, e.g. Jøtul, AH Industries, MCC and Euromaint, were not deemed ready for sale. On 30th November 2012 Ratos sold Contex with a net loss estimated at -125 MSEK.[32] *"The transaction markets rebounded during the fourth quarter last year [2013]. Prior to that it was completely flat. I haven't had this many IPO's in one quarter [Q1 2014] since 2007!"* (David Halldén, 25.4.2013). Most stakeholders consider Ratos decision to wait out the exit markets a reasonable decision: *"It would have been stupid to sell out just to take in cash. So if the alternative was to make an exit, the preferred stock issue was probably a better deal"* (Christian Hellman, 11.4.2014).

[32] Ratos does not disclose negative IRRs

6.6 Investors 'searching for yield'

While transaction markets remained subdued for most of the 2012 and 2013, the market for fixed income instruments was booming. Several of the interviewees attribute the issuance boom of fixed income instruments as companies riding a market trend. The underlying factor was the low interest environment, which left both institutional and retail investors desperately *searching for yield.* This supports the notion that Ratos actively pursued the overheated debt markets, where the yield was currently low and hence financing relatively cheap, in accordance with the *market timing theory.*

7. Concluding Remarks

Previous research argue that preferred stock is mainly used in companies with low or zero interest tax shields, either due to poor operating performance or low corporate tax rates. While Ratos usually pay little or no income taxes in the parent, our findings suggest that taxes did not play an explicit part in Ratos' decision to issue preferred stock. Rather, Ratos considered the current market environment, the ability to dictate the terms at which issuance took place, and the ability to create goodwill around the issue. These broader considerations are less explored in the existing literature.

Stein (1992) introduces the concept 'backdoor equity financing', where companies issue convertible debt when a new issue of equity is deemed unattractive due to asymmetric information. As the debt is subsequently converted to equity, equity enters the capital structure through the 'backdoor'. Similarly, Ratos issued an equity security with terms corresponding to debt financing, in order to achieve 'backdoor debt financing'. With a straight, redeemable preferred stock, Ratos was able to issue a security without the debt covenants, default events and additional financial risk that debt would imply. The preferred stock was designed to mimic the cash flow pattern of a coupon bond, with a strong signal that Ratos will initiate redemption after four years. Moreover, the redemption clause allows Ratos to refinance at current market terms, or repurchase the shares outstanding at a more favorable point in the cash flow cycle. Hence, Ratos was able to indirectly increase its leverage, without actually increasing its financial risk corresponding to a debt issue.

One important caveat of the preferred stock is that it allowed Ratos to enhance its financial flexibility. Graham and Harvey (2002) interpret financial flexibility as preserved debt capacity. As Ratos' debt capacity was effectively zero, the mandate to issue preferred stock added flexibility to Ratos' financing toolbox. Previously, Ratos could only tap into equity markets, but the debt-like features of the preferred stock enabled Ratos to access a broader marketplace. This expanded Ratos' investor base to include fixed income investors, and enhanced Ratos' ability to utilize and time favorable market conditions outside the equity markets. Hence, an important factor in the decision to issue preferred stock was the prevalent market conditions at the time. Booming corporate bond markets had pushed bond yields down to record-low levels, while investors were still scared of the turbulence surrounding the equity markets. *"Corporate bonds have been so popular that they trade above face value, pushing the yield down. The spread between corporate and treasury bonds are record low, so that's not as interesting [to investors] anymore. In preferred stock, investors get a relatively good yield at a relatively low risk. It is not risk-free, but significantly better than what you get in corporate bonds"* (Lena Krauss, 9.4.2014).

In summary, the preferred stock allowed Ratos to circumvent the potential negative effects of deviating from its no-debt policy, issuing common stock, or wiping out its annual dividend payments to common shareholders. The preferred stock offered a high, fixed dividend and lower equity risk to investors than its common counterparty. The combination of a low interest rate environment, a high-yield security and Ratos' blue-chip status ensured a successful issue. Moreover, the issue was sufficiently small to only make a dent in Ratos' ownership structure and dividend priorities. But regardless of what security Ratos chose to issue, the underlying motive remained the same: Ratos needed cash to finance its on-going operations as a private equity investor. *"It's a study of how you can make the glass look half-full, when it's really half-empty"* (David Halldén, 25.4.2014).

7.1 Avenues for further research

The case study is carried out less than one year after the issue. Hence, it would be interesting to see a follow-up study on the issuance and reception of subsequent series, and the price development of the initial series closer to its expected redemption in 2017.

While our thesis reveals important findings about the factors Ratos considered prior to issuance, the lack of research on preferred stock outside the U.S. limits our ability to draw any parallels to empirical studies that could hint at the importance of these factors in an aggregated setting. This clearly suggests a broad avenue of future research: studies of the general properties of listed preferred stock issues in non-U.S. samples. With regard to the market environment, future research could address to which extent preferred stock issues are correlated with a low interest rate environment or volatile equity markets. With regard to market reception, future research could address underpricing in preferred stock offerings and common stock reactions to preferred stock issues.

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Appendix

A. Ownership structure

Table A1
Series A 28.6.2013 (Source: SIS Ägarservice)

2013-06-28	Number of shares	Share capital % *	Voting rights % *
Söderberg Torsten stiftelse	16 030 900	8,6 %	12,5 %
Söderberg Ragnar stiftelse	12 633 340	8,4 %	14,7 %
Akademiinvest AB	5 600 000	1,7 %	0,5 %
SHB fonder	5 028 425	1,6 %	0,5 %
Avanza Pension Försäkring AB	4 936 451	1,5 %	0,5 %
Andra AP-fonden	4 694 260	1,4 %	0,4 %
SEB fonder	4 319 986	1,3 %	0,4 %
Svenskt Näringsliv	3 000 000	0,9 %	0,3 %
Stenhammar Olof o bolag	2 955 404	0,9 %	0,3 %
Alecta	2 760 000	0,8 %	0,3 %
Söderberg Lars	2 415 654	1,6 %	2,9 %
Fjärde AP-fonden	2 285 870	0,7 %	0,2 %
Tredje AP-fonden	2 251 168	0,7 %	0,2 %
Söderbaum Katarina	2 222 744	2,0 %	4,3 %
Montgomery Barbro	2 200 000	0,7 %	0,2 %
Danske Invest fonder (Sverige)	2 154 329	0,7 %	0,2 %
Nordnet Pensionsförsäkring AB	2 119 922	0,7 %	0,3 %
Söderberg Marie o bolag	2 096 964	1,2 %	1,9 %
Swedbank Robur fonder	2 048 825	0,6 %	0,2 %

*Of Ratos' total share capital respectively voting rights

Table A2
Series B 28.6.2013 (Source: SIS Ägarservice)

2013-06-28	Number of shares	Share capital % *	Voting rights % *
Söderberg Torsten stiftelse	16 030 900	8,6 %	12,5 %
Söderberg Ragnar stiftelse	12 633 340	8,4 %	14,7 %
Akademiinvest AB	5 600 000	1,7 %	0,5 %
SHB fonder	5 028 425	1,6 %	0,5 %
Avanza Pension Försäkring AB	4 936 451	1,5 %	0,5 %
Andra AP-fonden	4 694 260	1,4 %	0,4 %
SEB fonder	4 319 986	1,3 %	0,4 %
Svenskt Näringsliv	3 000 000	0,9 %	0,3 %
Stenhammar Olof o bolag	2 955 404	0,9 %	0,3 %
Alecta	2 760 000	0,8 %	0,3 %
Söderberg Lars	2 415 654	1,6 %	2,9 %
Fjärde AP-fonden	2 285 870	0,7 %	0,2 %
Tredje AP-fonden	2 251 168	0,7 %	0,2 %
Söderbaum Katarina	2 222 744	2,0 %	4,3 %
Montgomery Barbro	2 200 000	0,7 %	0,2 %
Danske Invest fonder (Sverige)	2 154 329	0,7 %	0,2 %
Nordnet Pensionsförsäkring AB	2 119 922	0,7 %	0,3 %
Söderberg Marie o bolag	2 096 964	1,2 %	1,9 %
Swedbank Robur fonder	2 048 825	0,6 %	0,2 %
Norges Bank Investment Management	1 828 512	0,6 %	0,2 %

*Of Ratos' total share capital respectively voting rights

Table A3
Series C 28.6.2013 (Source: SIS Ägarservice)

2013-06-28	Number of shares	Share capital % *	Voting rights % *
SHB Fonder	34 857	1,6 %	0,5 %
Tredje AP-fonden	20 000	0,7 %	0,2 %
SEB Fonder	16 611	1,3 %	0,4 %
Akademiinvest AB	11 990	1,7 %	0,5 %
Danske Invest Fonder (Sverige)	9 710	0,7 %	0,2 %
Stockholms Sjukhem	4 250	0,2 %	0,0 %
Nordnet Pensionsförsäkring AB	3 438	0,7 %	0,3 %
Söderberg Jan (Bolag)	3 200	4,5 %	13,3 %
Crafoordska Stiftelsen	2 610	0,2 %	0,1 %
Stenhammar Olof O (Bolag)	1 725	0,9 %	0,3 %
Swedbank Försäkring AB	915	0,2 %	0,1 %
Håkansson Björn	715	0,8 %	2,4 %
Montgomery Barbro	425	0,7 %	0,2 %
Söderberg Lars	400	1,6 %	2,9 %
Söderberg Agneta	290	0,3 %	0,8 %
Skandia Försäkring AB	57	0,2 %	0,1 %
Söderberg Per-Olof (Bolag)	-	5,1 %	15,3 %
Söderberg Ragnar Stiftelse	-	8,4 %	14,7 %
Söderberg Torsten Stiftelse	-	8,6 %	12,5 %
Söderbaum Katarina	-	2,0 %	4,3 %

*Of Ratos' total share capital respectively voting rights

Table A4
Series C 30.4.2013 (Source: SIS Ägarservice)

2014-03-31	Number of shares	Share capital %	Voting rights %
SHB Livförsäkring AB	19 042	0,2 %	0,1 %
Swedbank Försäkring AB	16 821	0,6 %	0,2 %
Nordnet Pensionsförsäkring AB	15 374	0,8 %	0,3 %
Avanza Pension Försäkring AB	14 247	1,6 %	0,5 %
Danske Invest fonder (Sverige)	9 710	1,0 %	0,3 %
SHB fonder	7 822	1,6 %	0,5 %
SEB Life International Assurance	6 334	0,3 %	0,1 %
Crafoordska stiftelsen	5 000	0,2 %	0,1 %
Söderberg Jan bolag	3 200	4,5 %	13,3 %
Uppsala Universitets stiftelseförv	2 943	1,0 %	0,3 %
Stenhammar Olof o bolag	1 725	0,9 %	0,3 %
SEB AB	1 291	0,2 %	0,1 %
Kungl Vitterhets Och Antikvitets	1 171	0,4 %	0,1 %
Svenska Akademien	1 118	0,4 %	0,1 %
Håkansson Björn	715	0,8 %	2,4 %
Skandia Försäkring AB	542	0,2 %	0,1 %
Montgomery Barbro	425	0,7 %	0,2 %
Söderberg Lars	400	1,6 %	2,9 %
Söderberg Agneta	290	0,3 %	0,8 %
Söderberg Torsten stiftelse	-	8,6 %	12,5 %
Söderberg Ragnar stiftelse	-	8,4 %	14,7 %

*Of Ratos' total share capital respectively voting rights

Table B1

Share capital development

Number of shares outstanding in each Series

Year	Transaction	Series A outstanding	Series B outstanding	Series C outstanding	Share capital (MSEK)
1999	Redemption C-shares	21 641 127	59 679 299		1 016
2001	Reduction	21 641 127	59 021 499		1 008
2003	Reclassification of A-shares to B-shares	21 244 658	59 417 968		1 008
2003	Nyemission	21 244 658	59 497 968		1 009
2004	New share issue, reduction and reclassification of A-shares to B-shares	21 229 056	59 445 570		1 008
2005	Reclassification of A-shares to B-shares	21 210 036	59 464 590		1 008
2006	Bonus issue, stock split and redemption	42 328 770	119 020 482		1 017
2008	Reclassification of A-shares to B-shares	42 328 530	119 020 722		1 017
2009	New share issue*	42 328 530	119 524 362		1 020
2010	New share issue**	42 328 530	119 741 918		1 021
2010	Reclassification of A-shares to B-shares	42 323 530	119 746 918		1 021
2011	Stock Split 2:1	84 637 060	239 503 836		1 021
2013	New share issue, preference shares			830 000	1 024

* Acquisition of a Finnish firm

** Acquisition of shares in HL Display from Anders Remium (217,556 Series B)

Table C1
Overview

Company	Industry	Investment year	Equity stake
DIAB	Composite material	2001	96%
GS-Hydro	Piping systems to offshore	2001	100%
HL Display	In-store communication	2001	99%
Inwido	Windows/doors mfc	2004	97%
Arcus Group	Wine & Spirits	2005	83%
Bisnode	Digital publishing	2005	70%
Hafa	Bathroom interior	2006	100%
Jøtul	Stove/fireplace mfc	2006	93%
AH Industries	Wind/marine/offshore	2007	69%
EuroMaint	Service/maint to trains	2007	100%
Mobile Climate Control	Climate control	2007	100%
Bioline	Scientific Pharma	2010	100%
KVD	Kvarndammen ecommerce	2010	100%
SB Seating	Office supplies	2010	85%
Aibel	Oil & Gas sub supplier	2013	32%
HENT	Civil & Commercial propert	2013	73%
Nebula	Hosting cloud services	2013	72%
Nordic Cinema Group	Cinema	2013	58%

Table C2
Performance

	Turnover		EBITA		EBT		Cash Flow	Investments
MSEK	2012	2011	2012	2011	2012	2011	2012	2012
AH Industries	1 062	925	-45	24	-72	-6	-79	50
Arcus-Gruppen	2 278	2 072	5	146	-73	78	-94	126
Biolin Scientific	235	232	23	15	14	0	-11	26
Bisnode	3 935	4 310	511	447	70	203	124	100
Contex Group	286	300	5	19	-150	7	-28	24
DIAB	1 003	1 219	-217	-5	-279	-50	-36	32
Euromaint	2 489	2 860	51	102	5	52	5	29
Finnkino	862	799	128	77	82	21	95	28
GS-Hydro	1 352	1 074	123	31	44	-13	63	21
Hafa Bathroom Group	268	324	7	-5	5	-2	-4	4
HL Display	1 657	1 643	104	64	70	24	70	51
Inwido	4 607	5 050	288	407	246	315	166	87
Jøtul	913	996	-52	-33	-152	-66	-81	68
KVD Kvarndammen	287	276	41	52	25	42	49	3
Mobile Climate Control	1 250	1 048	108	45	67	7	2	7
SB Seating	1 176	1 264	237	253	180	196	155	68
Stofa	1 572	1 390	180	146	88	96	92	153

Table C3

Cash injections

Yearly cash injections, excluding acquisitions

MSEK	2008	2009	2010	2011	2012
AH Industries	32	32		51	50
Arcus-Gruppen	21	190	35	63	126
Biolin Scientific			7		26
Bisnode	206	119	95	133	100
Contex Group	60	59	55	55	24
DIAB	81	49	81	67	32
Euromaint	41	25	28		29
Finnkino					28
GS-Hydro		27	15	10	21
Hafa Bathroom Group		5	4	2	4
HL Display	29	24		53	51
Inwido	205	84	69	81	87
Jøtul	56	39	67	73	68
KVD Kvarndammen				2	3
Mobile Climate Control			50	13	7
SB Seating		37	23	33	68
Stofa				143	153
Others*	831	683	417	203	
Total	**1 562**	**1 373**	**946**	**982**	**879**

*Portfolio companies not part of Ratos portfolio in 2012

Table C4

Acquisitions

Yearly acquisitions including supplementary acquisitions since 1999

	1999		2000		2001	
	Company	MSEK	Company	MSEK	Company	MSEK
	Superfos	325	Camfil	450	Lindab	1066
	Dahl	562	DataVis	254	Dynal Biotech	292
			Q-Labs	190	Atle (13 firms)	3200
			Overseas Telecom	184	Hilton	565
	2002		**2003**		**2004**	
	Company	MSEK	Company	MSEK	Company	MSEK
			Bluegarden	392	BTJ InfoData	250
			LRT/Tornet	670	Inwido	473
					Bisnode	201
Supplementary	Arcorus	159			Arcorus	135
Acquisitions	Superfos	80			Gadelius	66
					Haendig	112
	2005		**2006**		**2007**	
	Company	MSEK	Company	MSEK	Company	MSEK
	Arcus	474	Jøtul	276	HÅG/RH/RBM	747
	Anicimex	535	Medisize	280	MCC	298
					AH Industries	304
					Euromaint	417
					Contex Group	683
Supplementary	Bisnode	136	Bisnode	380	Inwido	250
Acquisitions	Hägglunds Drives	391				
	2008		**2009**		**2010**	
	Company	MSEK	Company	MSEK	Company	MSEK
					Stofa	668
					HL Display	1 017
					KVD Kvarndamme	360
					Biolin Scientific	306
Supplementary	Medisize	393	DIAB	387	Euromaint	166
Acquisitions	MCC	210	Inwido	400	Medisize	60
	Bisnode	305	Inwido (Finland)	89	AH Industries	283
			Euromaint	25		
	2011		**2012**		**2013**	
	Company	MSEK	Company	MSEK	Company	MSEK
	Finnkino	402			Aibel	1676
					Nebula	284
					HENT	347
Supplementary	MCC	114	Arcus	77	SF Bio	0
Acquisitions	Biolin Scientific	65			Jøtul	13

Table C5

Exits

Yearly exit IRRs from 1999. Note that negative IRRs are generally not disclosed

1999

Company	IRR
8 small IT-firms	236%
Prifast	544%
Meto	391%
TV 8	neg.

2000

Company	IRR
Telelogic	1084%

2001

Company	IRR
Scandic	20%
Sweden On Line	neg.

2002

Company	IRR
Hilton	15%
Kronans Droghandel	9%
Exceed	15%
Esselte	14%

2003

Company	IRR
Giga Consulting	neg.
Capona	29%
DataVis	neg.
Hilding Anders	28%

2004

Company	IRR
Dahl	35%
Q-Labs	neg.

2005

Company	IRR
Martinsson	neg.
Dynal Biotech	24%

2006

Company	IRR
Tornet	70%
Gadelius	2%
Lindab	30%

2007

Company	IRR
Alimak Hek	30%
Bluegarden	6%

2008

Company	IRR
Hägglunds Drives	55%
Atle Industri	8%

2009

Company	IRR

2010

Company	IRR
Haglöfs	30%
Lindab (partly)	19%

2011

Company	IRR
Medisize	4%

2012

Company	IRR
Anticimex	24%
Camfil	13%
Lindab	11%
Superfos	2%

2013

Company	IRR
Contex	neg.
BTJ	neg.
Stofa	54%

Table D1
Properties of listed preferred stock in Sweden

Company	Penalty	Redemption	Liquidation	Issuance Year	Expected Redemption
Corem*	8%	175	150	2010	
Ratos	10%	2 013	2 013	2013	2017
Eniro	20%	560	560	2012	2017
Klövern	8%	175	150	2012	
Victoria park	10%	325	325	2013	
Balder	14%	350	300	2011	
Oscar Properties	20%	280	280	2013	
SAS	-	600	600	2014	2018
Sagax	7%	35	30	2006	
ALM Equity	9%	120	100	2011	
Fast Partner	8%	350	300	2013	

*Bonus issue

Table D2
Dividend yield at issue and as of 30.4.2014

Company	Issue price (SEK)	30.4.2014 (SEK)	Dividend (SEK)	Issue yield	Dividend yield
Corem*	n/a	159	10	-	6,3%
Ratos	1750	1 930	100	5,7%	5,2%
Eniro	400	509	40	10,0%	7,9%
Klövern	136	159	10	7,4%	6,3%
Victoria Park	250	304	20	8,0%	6,6%
Balder	329	351	20	6,1%	5,7%
Oscar Properties	210	265	24	11,4%	9,1%
SAS	500	504	50	10,0%	9,9%
Sagax	30	35	2	6,8%	5,8%
ALM Equity	110	125	8	7,6%	6,7%
Fast Partner	293	387	20	6,8%	5,2%

*Bonus issue

Table E1
t-test of CAR (-1, 1) in STATA

Variable	Obs	Mean	Std. Err.	Std. Dev.	[95% Conf. Interval]	
car	3	-.0088527	.0050008	.0086616	-.0303694	.0126639
H_0: mean = 0					t = -1.7703 df = 2	
Ha: mean < 0 Pr(T < t) = 0.1094		Ha: mean != 0 Pr(|T| > |t|) = 0.2187			Ha: mean > 0 Pr(T > t) = 0.8906	

Table E2
t-test of CAR (-20, 20) in STATA

Variable	Obs	Mean	Std. Err.	Std. Dev.	[95% Conf. Interval]	
car	41	-.1082148	.0077366	.0495387	-.1238512	-.0925785
H_0: mean = 0					t = -13.9873 df = 40	
Ha: mean < 0 Pr(T < t) = 0.0000		Ha: mean != 0 Pr(|T| > |t|) = 0.0000			Ha: mean > 0 Pr(T > t) = 1.0000	

Table E3

Abnormal and cumulative abnormal returns -20 to +20 days around announcement date.

Including t-statistics based on bootstrapped estimates of the standard error of AR with 200 replications.

Day	AR	t-test AR	t-test AR (Bootstrapped)	CAR	t-test CAR (Bootstrapped)
-20	1,09%	.8147106	9.462107	1,09%	1.477733
-19	-2,11%	-1.575406	-18.29688	-1,02%	-1.37976
-18	0,15%	.113677	1.320253	-0,87%	-1.173571
-17	-1,28%	-.9588125	-11.13572	-2,15%	-2.912678
-16	-1,19%	-.8857304	-10.28694	-3,34%	-4.519227
-15	0,81%	.6075854	7.056541	-2,52%	-3.417181
-14	-1,39%	-1.037601	-12.05077	-3,91%	-5.299195
-13	1,10%	.819837	9.521646	-2,81%	-3.812164
-12	-3,33%	-2.485117	-28.86233	-6,14%	-8.319702
-11	-2,84%	-2.119222	-24.6128	-8,98%	-12.16358
-10	-0,95%	-.7088011	-8.232067	-9,93%	-13.44921
-9	0,20%	.1478641	1.717304	-9,73%	-13.18101
-8	0,19%	.138815	1.612208	-9,54%	-12.92923
-7	0,04%	.032574	.3783166	-9,50%	-12.87014
-6	-1,25%	-.9347447	-10.85619	-10,75%	-14.56559
-5	-0,36%	-.2713484	-3.15146	-11,11%	-15.05777
-4	-1,80%	-1.343822	-15.60725	-12,91%	-17.49521
-3	-0,23%	-.1684183	-1.956022	-13,14%	-17.80069
-2	0,47%	.3519154	4.087172	-12,67%	-17.16238
-1	-0,31%	-.2327722	-2.703433	-12,98%	-17.58459
0	-0,15%	-.1127363	-1.309327	-13,13%	-17.78907
1	-1,42%	-1.059971	-12.31058	-14,55%	-19.71166
2	-0,21%	-.1584277	-1.839991	-14,76%	-19.99902
3	1,25%	.9360864	10.87178	-13,51%	-18.30113
4	1,46%	1.094032	12.70617	-12,04%	-16.31676
5	-0,82%	-.609004	-7.073017	-12,86%	-17.42138
6	-0,18%	-.1367375	-1.588079	-13,04%	-17.6694
7	-0,42%	-.3101704	-3.602342	-13,46%	-18.23199
8	-0,36%	-.2710474	-3.147965	-13,82%	-18.72362
9	-1,31%	-.9771023	-11.34814	-15,13%	-20.4959
10	0,65%	.482307	5.601549	-14,48%	-19.62109
11	-0,42%	-.3154037	-3.663121	-14,90%	-20.19317
12	0,68%	.5098826	5.921813	-14,22%	-19.26834
13	-0,84%	-.6249814	-7.258579	-15,06%	-20.40194
14	-1,04%	-.779873	-9.057501	-16,10%	-21.81648
15	-0,13%	-.095024	-1.103615	-16,23%	-21.98884
16	0,39%	.2882751	3.348048	-15,84%	-21.46596
17	1,94%	1.448455	16.82246	-13,90%	-18.83873
18	-0,89%	-.6620628	-7.689245	-14,79%	-20.03959
19	1,57%	1.175024	13.64681	-13,22%	-17.90832
20	-2,50%	-1.865851	-21.67013	-15,72%	-21.29262

Text F1
Taxation (Source: Ratos, 2013)

Moderbolaget beskattas enligt reglerna för investmentbolag. Dessa innebär att uppkomna kapitalvinster på aktier och andra delägarrätter inte är skattepliktiga. Kapitalförluster är inte avdragsgilla. Bolaget deklarerar en schablonintäkt på 1,5% på marknadsvärdet av noterade aktier som vid årets ingång innehafts mindre än ett år och där ägarandelen understiger 10% av rösterna. Mottagna utdelningar och ränteintäkter redovisas som skattepliktig intäkt. Räntekostnader och omkostnader är avdragsgilla liksom lämnad utdelning. Dessa regler leder normalt till att moderbolaget inte betalar någon inkomstskatt. Moderbolagets skattekostnad 2013 uppgår till 0 Mkr (0).

Text F2
Extracts from Swedish Companies Act

Likhetsprincipen
1 § Alla aktier har lika rätt i bolaget, om inte annat följer av 2-5 §§.

Föreskrifter om olika aktieslag

2 § I bolagsordningen får det föreskrivas att aktier av olika slag skall finnas eller kunna ges ut. En sådan föreskrift skall innehålla uppgift om

1. olikheterna mellan aktieslagen, och
2. antalet eller andelen aktier av varje slag.

I en uppgift enligt första stycket 2 får anges det högsta och det lägsta antalet eller den högsta och den lägsta andelen aktier av ett visst slag.

Föreskrifter om företrädesrätt vid nyemission av aktier eller emission av teckningsoptioner eller konvertibler

3 § Om en föreskrift enligt 2 § innebär att aktierna skall ge olika rätt till bolagets tillgångar eller vinst eller att aktierna skall ha olika röstvärde, skall det i föreskriften anges vilken företrädesrätt aktieägarna skall ha vid sådan nyemission av aktier eller sådan emission av teckningsoptioner eller konvertibler som inte sker mot betalning med apportegendom.

En föreskrift om företrädesrätt enligt första stycket skall innebära

1. att aktieägarna skall ha företrädesrätt i förhållande till deras andel i bolagets kapital, eller
2. att en gammal aktie skall ge företrädesrätt till ny aktie av samma slag, att aktier som inte tecknas av de i första hand berättigade aktieägarna skall erbjudas samtliga aktieägare och att, om inte hela antalet aktier som tecknas på grund av sistnämnda erbjudande kan ges ut, aktierna skall fördelas mellan tecknarna i förhållande till det antal aktier de äger och, i den mån detta inte kan ske, genom lottning.

En föreskrift enligt andra stycket 2 får tas in i bolagsordningen endast om skillnaderna mellan aktierna är av det slag som anges i första stycket.

Föreskrifter om rätt till fondaktie

4 § Om en föreskrift enligt 2 § innebär att aktierna i bolaget inte skall ge lika rätt till andel i bolagets tillgångar eller vinst, skall det i bolagsordningen också anges vilken rätt aktieägarna skall ha till nya aktier vid en ökning av aktiekapitalet genom fondemission.

Röstvärdesskillnader

5 § Ingen aktie får ha ett röstvärde som överstiger tio gånger röstvärdet för någon annan aktie.

Majoritetskrav vid val
41 § Vid val anses den vald som har fått de flesta rösterna. Vid lika röstetal avgörs valet genom lottdragning, om bolagsstämman inte före valet beslutar att en ny omröstning skall genomföras i händelse av lika röstetal.

Första stycket gäller inte om annat föreskrivs i bolagsordningen. I bolagsordningen får dock inte föreskrivas att det för giltigt val fordras fler röster än som anges i första stycket.

Majoritetskrav vid beslut om ändring av bolagsordningen

42 § Ett beslut om ändring av bolagsordningen är giltigt om det har biträtts av aktieägare med minst två tredjedelar av såväl de avgivna rösterna som de aktier som är företrädda vid bolagsstämman, om inte annat följer av 43-45 §§.

43 § I följande fall är ett beslut om ändring av bolagsordningen giltigt endast om det har biträtts av samtliga aktieägare som är närvarande vid bolagsstämman och dessa tillsammans företräder minst nio tiondelar av samtliga aktier i bolaget, nämligen om beslutet när det gäller redan utgivna aktier innebär att

1. aktieägarnas rätt till bolagets vinst eller övriga tillgångar minskas genom en föreskrift enligt 3 kap. 3 §,
2. rätten att överlåta eller förvärva aktier i bolaget inskränks genom förbehåll enligt 4 kap. 8, 18 eller 27 §, eller

3. rättsförhållandet mellan aktier rubbas.
44 § I följande fall är ett beslut om ändring av bolagsordningen giltigt endast om det har biträtts av aktieägare med minst två tredjedelar av de avgivna rösterna och nio tiondelar av de aktier som är företrädda vid bolagsstämman, nämligen om beslutet innebär att
1. det antal aktier för vilka aktieägarna får rösta vid bolagsstämman begränsas,
2. av nettovinsten för räkenskapsåret, efter avdrag för vad som går åt för att täcka balanserad förlust, viss del skall avsättas till en bunden fond, eller
3. användningen av bolagets vinst eller dess behållna tillgångar vid dess upplösning begränsas på annat sätt än som avses i 43 § 1 eller punkten 2 i denna paragraf.
45 § I följande fall är ett beslut om en sådan ändring av bolagsordningen som avses i 43 och 44 §§, trots vad som sägs där, giltigt, om det har biträtts av aktieägare med minst två tredjedelar av såväl de avgivna rösterna som de aktier som är företrädda vid bolagsstämman, nämligen om
1. ändringen försämrar endast viss eller vissa aktiers rätt och samtycke till ändringen lämnas av samtliga vid bolagsstämman närvarande ägare av sådana aktier och dessa ägare tillsammans företräder minst nio tiondelar av alla aktier vars rätt försämras, eller
2. ändringen försämrar endast ett helt aktieslags rätt och ägare till hälften av alla aktier av detta slag och nio tiondelar av de vid bolagsstämman företrädda aktierna av detta slag samtycker till ändringen.

Generell inskränkning i bolagsstämmans beslutanderätt (Generalklausulen)

47 § Bolagsstämman får inte fatta ett beslut som är ägnat att ge en otillbörlig fördel åt en aktieägare eller någon annan till nackdel för bolaget eller någon annan aktieägare.