#### **Gentlemen Prefer Shares**



# **Perpetual and Retractible Preferred Shares**

James Hymas

o, you've decided to make a preferred share investment! Very good, but unfortunately you can't just buy a pound of prefs at the supermarket. A plethora of preferred shares is available and market professionals such as myself have developed intricate jargon in order to ensure that ordinary investors have to pay us for an explanation.

Penitence is a virtue, however, and this column will introduce "perpetual" and "retractible" preferred shares, with examples of how one might see them described when making an investment decision. It's very dry stuff, I'm afraid, but you have to know the rules before you can play the game!

When investing it is always highly desirable to get one's information from the horse's mouth and with most securities issues this means the prospectus. The prospectus for a preferred share may sometimes be available on the issuer's website (for instance, CIBC has a very good page of data on its preferred share issues at http://www.cibc.com/ca/investor-relations/share-info/preferred-shares/preferreddividends.html or through the regulator's website, http:// www.sedar.com). Obtaining a prospectus can be a frustrating experience but if you want to ensure that you are performing your calculations accurately, it's necessary. Other secondary sources of information regarding specific preferred share issues are the "FP Equities - Preferreds and Derivatives" annual handbook or summary reports produced on a monthly or quarterly basis by full-service investment dealers. Your local library may be able to assist you in obtaining something of this nature.

### CM.PR.P: a Perpetual

Let's have a look at the CIBC Series 18 preferred shares, which are traded on the Toronto Stock Exchange under the ticker symbol CM.PR.P. We'll look at the prospectus, since then we may be absolutely sure the information is as complete and accurate as the regulatory authorities can enforce.

Under the heading "Redemption" we find the following paragraph: "The Series 18 Shares will not be redeemable prior to October 29, 2012. On and after this date, but subject to the provisions of the Bank Act, including the requirement of the prior consent of the Superintendent, and to the provisions described below under 'Restrictions on Dividends and Retirement of Shares', the Bank may, at its option, at any time redeem all or from time to time any part of the outstanding Series 18 Shares by the payment of an amount in cash for each such share so redeemed of \$25.00 together with all declared and unpaid dividends to the date fixed for redemption."

The "Restrictions" section of the prospectus referred to in the above is of little interest—shareholders are allowed certain veto powers if the dividends haven't been paid but we will assume, at least for current purposes, that we can count on the CIBC to keep its word and pay its dividends at the proper time. As for the Superintendent, his role is to ensure that the bank doesn't put its solvency at risk by paying back money it doesn't have to, i.e. not to ensure that investors in preferred shares are happy. Don't count on him to stop the bank from redeeming shares if that's in the bank's best interest.

Further perusing the prospectus, we find no mechanism whereby the shareholder will automatically get his money back from the company, or whereby CIBC can be forced to pay back the money loaned. If you have lent money to the CIBC (or taken over the loan originally made by another investor by buying the shares on the stock market) through this issue of preferred shares and want to get your money back, you have only two options:

- Sell the shares on the open market, or
- Hope that the CIBC will decide to redeem the shares.

This is a major difference from the state of affairs with which bond investors are familiar, i.e. bonds have a definite stated maturity date on which investors should get their capital back.

Since there is no way in which you or any other investor can force CIBC to return the money they originally received for issuing CM.PR.P, these shares are referred to as perpetuals—these shares can be in existence forever. This could be an extremely bad thing for the holders of these shares. The annual dividend payment of \$1.375 or 5.5% on the face value of CM.PR.P looks very good now, but you might not be as enthralled should market yields skyrocket to the point where comparable new issues paid \$2.00 per share per year or 8%. The effect of changes in market yield on the price of individual issues will be examined in a future column. For now it will be sufficient to understand the difference between perpetuals and retractibles.

#### **GWO.PR.I:** a Perpetual

Let's look at another issue, GWO.PR.I. We can get the full formal name of the issue from the Toronto Stock Exchange. Go to http://www.tsx.com, type "GWO.PR.I" in the text box at the upper right, click "Get Quote" and a page is displayed with the most recent trading information. We are also told that the company is "Great-West Lifeco" and the full name of the issue is "Gt-West Lifeco Pr I". Click the link for a "5 year (w)" chart and we see that this is a recent issue, having started trading in April 2006.

To get the prospectus, go to http://www.sedar.com and click the box for the "English" version of the site (I haven't checked the French version). Click "Search Database", then "Search for Public Company Documents". Type "Great West Lifeco" in the text box for "Company Name" and set the "Document Type" to "Prospectus". The default "Date of Filing" includes the period in which a prospectus will have been issued (usually two weeks or so prior to the listing of the issue on the exchange) so we won't change it. Click "Search"—and nothing gets found!

SEDAR can be infuriating, but that serves us right for using the free web service instead of paying extra for a competently designed information system. Click "Modify Search" and...let's try putting a hyphen in between "Great" and "West". That's how the company was listed on the TSX site.

Success! There's a link to a prospectus dated April 6. Click on the description of the document, fill out the form to accept the terms of use and to indicate to the regulators that, although we cannot formally kow-tow over the Internet, we most certainly would if they graced us with their presence, and there we have it! The prospectus for the issue that matches the TSX description is now displayed on the screen.

The second paragraph of the issue description reads: "On and after June 30, 2011, Great-West Lifeco Inc. ('Great-West Lifeco' or the 'Corporation') may, on not less than 30 nor more than 60 days' notice, redeem for cash the Series I First Preferred Shares in whole or in part, at the Corporation's option, at \$26.00 per share if redeemed prior to June 30, 2012, \$25.75 per share if redeemed on or after June 30, 2012 and prior to June 30, 2013, \$25.50 per share if redeemed on or after June 30, 2013 and prior to June 30, 2014,\$25.25 per share if redeemed on or after June 30, 2014 and prior to June 30, 2015 and \$25.00 per share if redeemed on or after June 30, 2015, in each case together with all declared and unpaid dividends to but excluding the date of redemption. See 'Details of the Offering'."

We find nothing unusual in the "Details of the Offering" and we also find nothing that indicates that the holder can force the company to take back the shares. This is a "perpetual" issue—the terms differ from our previous example by the specifics of the dates on which the company can force us to give up the issue for specified prices. Note that they are willing to pay extra in order to redeem it earlier. This gives the holder some protection against the issue being called too soon, although the issuer will probably not redeem the issue early unless it is to their advantage.

#### WN.PR.B: a Retractible

We'll try another. WN.PR.B is "Weston George II Pr" and appears (from the TSX's 5-year chart) to have been issued in the spring of 2002. SEDAR provides us with the prospectus, dated April 4, 2002, for the "George Weston Limited 5.15% Cumulative Redeemable Preferred Shares, Series II". In turn, the prospectus provides the information: "On and after April 1, 2009, the Company may, at its option, on not less than 30 nor more than 60 days' notice, redeem for cash the Series II Preferred Shares, in whole or in part, at \$25.00 per share plus accrued and unpaid dividends to but excluding the date of redemption, or may, at its option, on not less than 40 days' notice and subject to stock exchange approvals, convert the Series II Preferred Shares into that number of the common shares of the Company (the 'Common Shares') determined by dividing \$25.00 together with all accrued and unpaid dividends to but excluding the date of conversion by the greater of \$2.00 and 95% of the then Current Market Price (as defined herein) of the Common Shares. See 'Details of the Offering'."

"On and after July 1, 2009, and subject to the Company's right on not less than 40 days' notice before the conversion date to redeem or arrange for the sale to substitute purchasers, the Series II Preferred Shares are convertible at the option of the holder on the first day of January, April, July and October in each year, on not less than 65 days' notice, into that number of Common Shares determined by dividing \$25.00, together with accrued and unpaid dividends to but excluding the date of conversion, by the greater of \$2.00 and 95% of the then Current Market Price of the Common Shares. See 'Details of the Offering'."

Here's something new! The company can force the holder to take either cash or common shares in exchange for the preferreds, or the holder can force the company to cough up the shares. There's a mention of a \$2.00 price of the common—quick, what's WN common trading at? The TSX quotation screen tells us it's now above \$80, so we will ignore the floor on the conversion price for now. If the common goes below \$2, the preferreds and other debt probably won't be worth much no matter what we do!

What about that "95% of the then Current Market Price (as defined herein)" that is talked about? The definition is on page S-8 and seems reasonable enough...it's basically the average trading price in the month prior to conversion. This discount on the common allows us to conservatively assume that in the event such an exchange gets made, we'll be able to sell these common shares on the TSX to get net proceeds of at least \$25 per preferred share even after paying the trading commissions.

And that will apply if we force the conversion too! Mind you, according to the terms of the prospectus, the company can force the holder to take cash, by finding a "Substitute Purchaser" but then the price of \$25 per preferred share is guaranteed. So, that's all right.

## Retractibles are more like Bonds than are Perpetuals

What all this means is that assuming that Weston continues to remain solvent, with a common share price in excess of \$2, the holder will be able to get \$25 cash for the preferreds in the period commencing July 2009 (possibly through receiving and instantly selling the common stock). This is a very important feature. It puts a floor underneath the value of the shares and makes them a lot more like bonds than are the "perpetuals". It is clear that, all else being equal, retractibles are better for the investor than are perpetuals. A retractible gives the holder the opportunity to get the face value of his investment back from the company at some specified time; a perpetual allows the company the opportunity to keep the money forever, paying only the dividend agreed at the time of issue. Older investors who remember the 1970s, inflation shocks and the sudden appearance of double-digit interest rates will understand what investment risks are implied by that notion!

This being the investment business, however, all else is not equal in the comparison between perpetuals and retractibles. Why would an investor purchase a perpetual preferred share that can possibly do worse than a retractible? The answer, of course, is because he's hoping that it will do better because perpetual issues generally pay a higher dividend than do retractibles. In the next column, we'll look more carefully at how issues of these types may be compared.

James Hymas, CFA, Hymas Investment Management, 129 Humbercrest Blvd, Toronto, ON, M6S 4L4 (416) 604-4204, jiHymas@himivest.com. James specializes in preferred share analysis.