

Seeking Alpha<sup>α</sup>

Dividend Ideas

# Flight To Quality Options Among Preferreds

Aug. 13, 2021 9:00 AM ET | BIP, CG, LYB... | 6 Comments | 6 Likes

## Summary

- The decline in rates has made investment grade preferreds and baby bonds more attractive.
- Recent issuances provide a benchmark for identifying relative value among preferreds.
- We examine five good relative value plays: CGABL, SLMNP, BIP-B, PSA-P, and OPP-A.
- Looking for a helping hand in the market? Members of Yield Hunting: Alt Inc Opps get exclusive ideas and guidance to navigate any climate. [Learn More »](#)



designer491/iStock via Getty Images

*(This report was issued to members of Yield Hunting on July 20th)*

**Update:** Since this article was published to members on 7/20, the 10 Year Treasury rate has moved up 16 bps, making these high duration preferreds a little less attractive. Prices for some of these securities have changed and/or ex-dividends have passed. CGABL went ex-div for 29 cents and has moved up in price from the 25.30s to the 25.70s. BIP-B is up about 15 cents but the 8/30 ex-div date is around the corner. PSA-P is roughly at the same price and is the most rate sensitive security discussed in this article. Also, PSA recently issued a new preferred at 3.95% making PSA-P's 4% less attractive in the 25.30s. OPP-A went ex-div for 27 cents, rebounded right to where it was prior to the ex-div but has now pulled back to the 24.70s on rate fears. SLMNP has dropped from 1040 to the upper 1020s, largely on misplaced fears related to new rules that impact "Pink-no info" OTC securities. SLMNP is not impacted by these rules as it meets exception criteria that allow it to be "Pink-current info".

Contrary to the consensus view, long rates have declined sharply from their March peak. While it's unclear whether the past four months have been a counter-trend move or representative of a cyclical shift, it's useful to explore opportunities that benefit from lower rates - namely, IG rated securities with significant call protection.

While the absolute yield on IG securities is not exciting, they can provide the opportunity for capital gains when they are mispriced relative to comparable securities. Recent issuances provide the best benchmark for determining fair market value since they are priced by banks with insight into market demand. Banks also have little incentive to overprice issues since losses from overpricing accrue to them while gains from underpricing accrue to the issuer.

Some recent benchmarks (in order from newest to oldest):

Issuer	Industry	Symbol	Rating	Coupon	Recei Price
Stifel	Bank	STFLV/SF-D	BB-	4.5%	N/A
First Republic	Bank	FRBSP/FRC-M	Baa3/BBB-	4%	24.87
AMG	Asset Mgmt	N/A	Baa1/BBB-	4.2%	N/A
Renaissance	Insurance	RNR-G	Baa2/BBB	4.2%	25.65
CMS Energy	Utility	CMS-C	Ba1/BBB-	4.2%	25.55

## Investment Grade Options

### CGABL: Carlyle Group 4.625% Jr. Sub Notes

**Price: 25.35 | Rating: BBB- | Maturity: 2061 | Call: 5/2026**

This is the first issuance from the DC-based asset management firm Carlyle Group (\$245B AUM). The company has a BBB+ sr. unsecured rating. It is unclear why Fitch and S&P have notched this jr. subordinated debt two steps below the sr. unsecureds when one step is typical for sub debt. A two-notch reduction in rating is typically assigned to preferreds, not higher ranking jr. sub notes. The notes allow for up to five years of interest payment deferral which is not unusual for jr. sub debt. Unlike financial services preferreds, jr. sub debt is cumulative. On the downside, interest payments are ordinary income as opposed to financial preferreds which are qualified.

Coverage is strong with \$16B of common stock covering \$500M of jr. sub debt for a coverage ratio of 32x. Their 2029 sr. bond yields 2.29%, so you're getting 200+ bps of extra yield which is a generous spread for an IG preferred.

There's about 21 cents of accrued interest, so the clean price is under 25.15. That results in a solid yield for a BBB- (arguably BBB) rated security when comparables are pricing at 4.2% and below.

### **SLMNP: A. Schulman 6% Preferred (par \$1000)**

**Price: \$1040 | Rating: Ba1/BB/BB+ | Call: Uncallable | Tax: Qualified**

This is a quirky, illiquid, OTC issue from \$31B market cap chemicals company LyondellBasell (LYB). It was originally a convertible preferred from A. Schulman until the company was acquired by LYB in 2018. Originally, the preferred could be converted into 19.11 common shares at the holders' option. Schulman was purchased for consideration of \$42/share plus 1 CVR related to pending litigation. The merger agreement allows for holders of SLMNP to convert their preferred - at any time (prior to bankruptcy) - into 19.11 \* the merger consideration, or \$802.62 of cash plus 19.11 CVRs. Someone posted a comment online saying they spoke with IR who said each CVR is worth \$2.379/share or  $19.11 * 2.379 = \$45.36$  per preferred.

The SEC filing documenting this information is [here](#).

LYB was downgraded by all three rating agencies in October 2020 after a debt funded acquisition. Prior to that, the preferred would be IG rated using standard notching (although technically the preferred is unrated). However, the ability to convert the preferred into cash at any time makes it less risky than LYB's BBB rated sr. unsecured bonds. This theory was put to the test in March 2020 when SLMNP never went below \$801 but LYB's BBB+ rated sr. unsecured bonds fell to the \$600s.

LYB's 2055 bond yields 3.35%, so you are getting 200+ bps extra yield with SLMNP while taking less risk and getting qualified tax treatment.

### **BIP-B: Brookfield Infrastructure 5% Preferred**

**Price: 25.15 | Tax: K1 | Rating: BBB- | Call: 2/2026**

BIP is a K1-issuing partnership with a \$23B market cap that owns a diversified set of critical infrastructure around the world. They have four operating segments - utilities, transportation (rail, terminals, toll roads), midstream, and data centers.

The company is based in Canada with dual listings on the NYSE and TSX. They have preferreds listed on both exchanges. While a 5% yield is nothing special for their Canadian listed preferreds (compared to other TSX preferreds), it's well above the yields available for IG preferreds in the US. The biggest detractor of the preferred is its K1, which generally results in pricing that is 25 bps worse than non-K1 securities. However, even accounting for the K1, BIP-B is undervalued compared to other IG securities.

BIP-B is also undervalued compared to BIP's other US-listed securities. BIP-A has a 5.125% coupon and trades at \$26. BIPH is a contingent jr. sub note that is equivalent in rank to a preferred. BIPH is identical to BIP-B (same 5% coupon, same BBB- rating, similar call protection) except it does not issue a K1 (payments are ordinary income) and it trades at 25.75.

### **PSA-P: Public Storage 4% Preferred**

**Price: 25.39 | Rating: A3/BBB+ | Call: 6/2026 | Tax: 199A**

PSA is regarded as the highest quality preferred in the par \$25 retail space. While that's not technically true (preferreds of CEF have higher credit ratings), perceptions matter more than facts when it comes to pricing.

While no one is getting excited over a 4% coupon, PSA-P is a good relative value with capital gains potential. It's also highly visible and liquid which makes it more likely that the relative value gap is closed sooner than later.

The most direct comps to the 4% PSA-P are the 3.9% PSA-O trading at 26.50 and the 3.875% PSA-N trading at 25.70. PSA-P also has about 20 days more accrued dividend than those two. Based on pricing of recent issuances, it's more likely that the recently issued PSA-P is undervalued than the more established O and N series are overvalued. The 10-year has already dropped by about 35 bps since PSA-P was issued, making it more attractive in relation to that benchmark. PSA-P would be a prime beneficiary of a further decline in rates given its high credit rating and long call protection.

### **OPP-A: Rivernorth CEF 4.375% Preferred**

**Price: 24.95 | Rating: A1 | Call: 11/2025 | Tax: Variable**

While AGC has written about OPP-A several times, it's worth another mention here due to its great relative value. There are almost no IG preferreds trading below par and certainly none with this kind of coupon. Preferreds of CEFs generally don't get extra credit for having ratings well above typical IG preferreds, so a reasonable comp would be the BBB- rated BAC-O which has the same coupon and was issued 13 days after OPP-A. That's trading at \$26, having traded at 26.50 just prior to its 7/14 ex-div. OPP-A's ex-div is coming up on 7/30, making this a good div capture opportunity or buy-and-hold.

Our Yield Hunting marketplace service is currently offering, for a limited time only, **free trials and 20% off the introductory rate.**

Our member community is fairly unique focused primarily on constructing portfolios geared towards income. The **Core Income Portfolio currently yields over 8%** comprised of closed-end funds. If you are interested in learning about closed-end funds and want guidance on generating income, check out our service today. We also have expert guidance on individual preferred stocks, ETFs, and mutual funds.

Check out our [Five-Star member reviews](#).

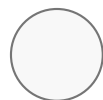
[Click here to learn more.](#)



YIELD HUNTING  
ALTERNATIVE INCOME INVESTMENTS

---

This article was written by



**Alpha Gen Capital**

15.93K Followers

Author of [Yield Hunting: Alt Inc Opps](#)

Safe 8+% Income Stream using CEFs, ETFs, Munis, Preferreds, and REITs.

**Disclosure:** I/we have a beneficial long position in the shares of LANDLORD LONG ALL POSITIONS either through stock ownership, options, or other derivatives. I wrote this article myself, and it expresses my own opinions. I am not receiving compensation for it (other than from Seeking Alpha). I have no business relationship with any company whose stock is mentioned in this article.

6 Likes

6 Comments

Comments (6)

Sort by

Newest

