



Two Convertible Debentures to Get You Started

Description

As promised in the [first post](#), here are two ideas for you to begin chewing on these hybrid securities:

Boyd Group Income Fund (TSX:BYD.UN)

Boyd Group operates over 200 collision repair service centres in Canada's 4 Western provinces and 13 U.S. states. The company is Winnipeg headquartered and has been around since 1990. Over the last five years or so it has seemingly really hit its stride as the stock has climbed more than 600%. This is a great example of where the downside protection/open upside offered by the convertible debenture comes in to play.

Boyd Group's convertible debenture matures in December 2017, carries a yield to maturity of 4.9% (effective yield you will receive over the life of the bond), and has a conversion price of \$23.40. The YTM compares nicely to the stock's dividend yield of 2.5%. The equity currently trades a bit south of \$19 so would have to appreciate by about 25% before conversion becomes a realistic possibility. If the next five years are anything like the past five years, this shouldn't be an issue.

However, Boyd trades at a free cash multiple of 14.5 according to Capital IQ. Its 10 year average multiple is 6.3. This is not an overly cheap stock. Should results stumble and this multiple revert to say 10 times free cash flow, the stock could fall from \$19 to the \$12-13 range. The impact will be far less severe for debenture holders as insolvency is unlikely. The bond characteristics will support the security.

Therefore, the Boyd Group convertible debenture (BYD.DB) offers a generous yield and the opportunity to participate in a growing business that has been a fantastic performer over the past five years. With steady free cash being produced, as long as the company doesn't go completely crazy with debt to fuel growth, insolvency is an unlikely outcome. Worst case you'll collect 4.9% per year over the next five years with this debenture. This is better than the worst case that equity owners face.

Canam (TSX:CAM)

Aside from downside protection, convertibles can also be used to produce an income stream that

otherwise doesn't exist. Canam is an example of a company that doesn't pay a dividend but the convertible carries a yield to maturity of 5.3%.

The conversion spread on the Canam convertible is wider than it was with Boyd Group. The stock currently trades at \$7.60 and the conversion price is \$12 (58% appreciation required), however, Canam is widely considered to be a cheap stock. Upside beyond \$12 is a distinct possibility.

The company is involved with industrial construction (buildings, structural steel, bridges) and the slowdown in the U.S. economy has impacted business. If the U.S. economy continues to recover, Canam appears poised to benefit.

Canam's stock currently trades below book value of \$8.62. In better economic times the company has traded as high as 2.2 times book value. If we use 2 times book as a peak multiple we get to an upside price of \$17 or so.

If you believe Canam's stock is capable of rising to this level, the equity is the way to play the name. However, if you are more of the belief that the U.S. economy doesn't improve dramatically from here, yet want the chance to participate if it does, Canam's debenture and its income producing quality might be the way to go. Without a dividend, the stock doesn't necessarily offer a payoff should the U.S. economy stall out.

The Foolish Bottom Line

Convertible debentures are another tool in the investor's tool kit. They don't always make sense, but occasionally, their downside protection and income producing characteristics are a fit for specific situations. If you absolutely love a company's prospects, convertibles are not the correct route as the equity will provide you with more bang for your buck. However, if you have doubts but don't want to miss out should the stock run, consider these hybrids as a way to make your play.

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