All You Need to Know About Altagas Ltd.'s Subscription Receipts

Description

Altagas Ltd. (TSX:ALA) has been building a portfolio of contracted power, regulated gas distribution, and highly contracted midstream assets. The company's cash flows are higher quality than they were in 2010 due to the company having a bigger portion from long-term contracts.

Its cost-of-service contracts have a weighted average term of about nine years, its take-or-pay contracts have a weighted average term of about 17 years, and its power-purchase agreements have a weighted average term of about 14 years.

Altagas wants to take its business to the next level by acquiring **WGL Holdings Inc.** (NYSE:WGL), which has regulated gas utilities that represent roughly 77% of its assets. Furthermore, WGL will double Altagas's rate base, triple its utility customers, and increase its gross power capacity to about 1,900 MW.

The acquisition will be accretive and make Altagas's dividend safer by improving the energy infrastructure NaturalGas-KM_16-9 Image not found or type unknown company's payout ratio.

WGL will also allow Altagas to grow its dividend by 8-10% per year through 2021.

This transaction represents an enterprise value of $8.4 billion. To raise a part of the investment capital, Altagas offered $2.1 billion of subscription receipts to the public at $31 per receipt. These receipts can be traded using the ALA.R symbol.

The receipts tend to trade at a discount to the common shares. So, investors can get a higher income from investing in the receipts.

Once the WGL acquisition closes, the receipts will turn into common shares of Altagas — one receipt for one common share.

However, the receipts are less liquid than the common shares. For comparison, there are about 2.5

times more Altagas common shares than the number of subscription receipts. So, if you intend to trade the receipts, set a limit price to do so.

I've received confirmation from Altagas investor relations that the subscription receipts are eligible investments for TFSAs, RRSPs, and RESPs.

Cash payments taxed differently from dividends

Although holders of the receipts will receive cash payments, which are the same amount as the dividends declared by Altagas on its common shares, the cash payments would be a mix of interest income and return of capital.

Dividend income is taxed favourably in non-registered accounts. However, interest income is taxed at the marginal rate and return of capital is tax deferred.

Return of capital reduces your adjusted cost basis and is essentially taxed as capital gains when you sell. Half of long-term capital gains are taxed at the marginal rate.

Investor takeaway

If you like Altagas, it seems reasonable to buy the subscription receipts, which trade at a discount to the common shares. However, if you don't have any room in a TFSA or RESP, it might make more sense (on a taxation basis) to buy the common shares in non-registered accounts instead.

If you plan to invest in RRSPs, from which withdrawals will be taxed at the marginal rate, it makes sense to buy the discounted subscription receipts.

Remember that in the end, the receipts will turn into common shares and start paying dividends if Altagas closes the WGL acquisition. So, receipt holders will be earning interest and return of capital income for about a year if Altagas acquires WGL by Q2 2018 as planned.

If the WGL acquisition fails, receipt holders will get their money back — $31 per receipt.

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