Enbridge Series 19 Preferred Stock: What to Know About the Coming Conversion

Description

The largest dividend payer on the TSX, **Enbridge Inc.** (TSX:ENB), has given its preferred stock investors an extended five years of superior dividends. However, investors have two tough choices to make this February. They will decide to earn either a fixed dividend yield or take chances and go for a (currently higher) floating rate that will reset every quarter over the next half a decade.

Enbridge paid $7.3 billion in total dividend cheques during the past 12 months, including more than $347 million in preferred share dividends. The company has 18 different tranches of preferred shares outstanding worth $6.8 billion on its books. Among other advantages, preferred shareholders are first in line to receive dividends if the company declares any dividends.

At given intervals, Enbridge has the right to buy back (or redeem) its issued preferred shares and reduce its dividend obligations. This time, it chose not to exercise its redemption rights, giving investors some lucrative options.

What’s happening?

In a notice issued on January 30, 2022, Enbridge stated it has no intention of redeeming its $500 million tranche of **Enbridge Inc. Cumulative Redeemable Minimum Rate Reset Preference Shares, Series 19 Shares** (TSX:ENB.PF.K), or Series 19 Shares. Enbridge recently spent $1 billion redeeming some of its preferred shares during the first nine months of 2022. This time, management decided to keep the 20,000,000 Series 19 shares, which were issued in December 2017, outstanding for at least another five years.

Investors have two options.

Option 1: Hold Series 19 and receive a 6.212% dividend. Investors can keep their original Series 19 Shares and receive a fixed 6.212% dividend for the next five years until March 2028. The dividend rate is based on the Government of Canada 5-Year Bond rate, plus a spread of 3.17%. The quarterly dividend should increase by 26.7% to $0.388 per Series 19 share.

Option 2: Convert to Series 20 and receive a quarterly floating dividend. Investors may opt to receive a floating dividend rate by converting their Series 19 Shares into Series 20 Shares. The Series 20 preferred dividend will initially be set at 1.92% for the next quarter, based on the Government of Canada's 3-month treasury bill auction rate plus a spread of 3.17%. Annualized, the floating dividend rate could be a much sweeter 7.68%. However, treasury bill rates change every week.

A choice must be made by February 14, 2023.

Conversion looks tempting

Five years is a reasonably long time. Investors' decision to hold Series 19 Shares or convert all or a part of them into Series 20 Shares depends on their opinion on future inflation, general interest rate outlook, and how much they tolerate risk and uncertainty.

The yield curve is inverted. Short-term interest rates are currently higher than long-term bond yields. Five-year bond yields are lower than treasury yields today. In turn, the fixed dividend rate of 6.2% on Series 19 shares appears inferior to the current floating offering of 7.68%.

Series 20 shares' floating dividends may provide superior returns if interest rates hold at current levels for the next five years. Not only will their annualized floating dividend be higher, but share prices may also appreciate offering some capital gains. Series 19 shares trade at $24.08 a share at writing. Their book value is $25 per share.

Buying Series 19 shares at current prices could earn investors a 6.4% dividend yield every year for five years, with a lower risk to their capital compared to buying volatile Enbridge common stock.

Would you go with a fixed dividend or gamble with a floating yield?

Converting to Series 20 looks tempting. That said, no one can tell how interest rates will play out over a long five-year investment horizon. On one hand, anything can trigger an economic recession at any time, and the Bank of Canada may lower interest rates. Dividend rates on Series 20 shares would suffer, and fixed rate Series 19 shares may outperform.

On the other hand, if inflation remains stubborn, treasury yields may rise higher, and dividends on Series 20 shares may increase in tune. Floating dividend rates provide better inflation protection as inflation rises.

Whether investors will go with certainty and receive a fixed dividend or take chances and convert to Series 20 depends much on your long-term view and risk tolerance levels.

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