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CFA Trending Topics | March 19, 2018

Time to shine, preferreds

As we mentioned last year in **CFA Trending Topics**, non-dilutive preferred stock is a more attractive financing tool in a post-tax reform world. With lower corporate tax rates and limitations on deductibility, the value of a tax deduction has arguably decreased, especially if non-deductible forms of capital offer other benefits such as rating agency equity credit and equity accounting treatment.

Progressive Corp appears to be one of the first to capitalize on this theme (and is not driven by regulatory capital needs):

- Progressive (A2/A) issued $500mm of preferred at 5.375%, redeemable at 100% any time after year five.
- Though their effective tax rate has historically been in the 32-33% range, they have guided to a significantly lower tax rate post tax reform of ~20%.
- The company's Moody's rating was also bolstered by 50% equity treatment on the preferred.
    - Most peers historically have issued tax-deductible hybrid debt at only 25% Moody's equity credit.

Key Takeaways

- Management teams should re-assess the fixed income capital markets where perpetual, non-dilutive capital is more attractive in a post-tax reform world.

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