Gibraltar Asset Management

Stockbrokers & Investment Managers

Thematic

General Accident 8 7/8% Preference Shares - Buy

19th June 2012

Price	104.5p
Credit Rating	N/A
Risk Rating	Medium
Running Yield	8.5%

Credit Analysts View:

The General Accident preference shares do not carry a credit rating. However, Aviva Plc is 'A' rating by S&P and comparable subordinated Aviva debt carry an investment grade 'BBB+' rating.

Preference Share

General Accident was founded in 1885 by a group of local businessmen in Perth, Scotland. It merged with Commercial Union to form CGU Plc in 1998, which subsequently merged with Norwich Union in 2000 to form CGNU Plc, later renamed Aviva Plc. Today, General Accident is a wholly-owned subsidiary of Aviva Plc, a FTSE 100 company.

The 8 7/8% preference shares are cumulative, meaning if the dividend is not paid one year, it is rolled up to the next.

They pay dividends twice a year - on the 1st of January and 1st of July.

Priced at 104.5p, they are currently trading on a mouth-watering yield of 8.5%. What's more having traded in the 120p to 150p range in recent times, the shares could also provide healthy capital gains too.

A Guide to Preference Shares:

Introduction

Issued mostly by banks and insurance companies (and their predecessors), preference shares pay a fixed dividend, net of tax, twice a year. Prices are dealt with accrued dividends in the dealing price.

Security

Preference shares rank behind all forms of company debt, including debentures, loan notes and bank debt, but ahead of ordinary shares. Only 3 out of 100 issues are currently in arrears.

Tax Benefits

As the dividends are paid out of taxed corporate profits they are classified as "franked investment income". This is beneficial for UK tax payers as they pay a fixed interest rate net while bonds pay a fixed interest rate gross.

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Thematic (cont)

A Guide to Preference Shares (cont):

Disadvantages

A takeover might result in reasonable terms being offered for the preference capital, or in them being left alone, but this is something of a grey area. They could be repaid at par, but this is unlikely. Their problem lies in the fact that you don't receive the growth element of ordinary shares nor the additional security of a corporate bond.

Dividend Payments

Companies have to pay preference dividends in full before they can pay an ordinary dividend. Many preference shares are also cumulative, meaning if the company misses a payment, the dividend rolls up and has to be paid in full, including any arrears, before the company can resume paying dividends on its ordinary shares.

Undated

Most preference shares are irredeemable, though some can be redeemed either at the market price at any time or at a pre-set price (usually par value) on a specific date (known as callable prefs). Like undated gilts, the prices of preference shares tend to be more sensitive to movements in interest rates than shares with a fixed redemption date. Yields are mainly affected by the perceived standing of the company in terms of financial robustness rather than the fact whether they are callable or cumulative.

Dealing

Preference shares are dealt for standard T+3 settlement, with a dirty price. This means that the accrued interest is included in the price, unlike with bonds. Stamp duty is payable on purchases.

Anomalies

Callable stocks can be less volatile than irredeemable prefs close to the date at which redemption may happen, yet do not tend to have lower yields. Cumulative preference shares tend not to have noticeably lower yields than non-cumulative ones, despite the greater likelihood – although no absolute uncertainty – of the dividend payment being made in full. Yields are mainly affected by the perceived standing of the company in terms of financial robustness.