

Debt Instruments - Convertible Bonds

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This is the second issue of the Debt Instruments Series – Convertible Bonds.

Convertibles are bonds or loans (CB or CL) which convertible bondholders or convertible loan lenders have a right to convert the bonds or loans into shares. The convertible right can be exercised any time within a certain period (usually during the life of the Convertible Bonds or Loans). The conversion price is set at a fixed premium above the share price at the time of CB issue.

Merits of Convertible Bonds:

Issuer:

- 1) Interest rate burden is lower than traditional bonds or loans;
- 2) If bondholders convert the bonds into shares, the company does not need to make cash repayment; and
- 3) There is no need to issue shares at the current undervalued price. The conversion price is set at a premium.

Investor:

- 1) Risk on equity investment is reduced because he can choose when to convert; and
- 2) The interest rate (although low) may give investor a return even if share price does not move above the conversion price.

Bond with warrants:

Bond with warrants is quite similar to convertible bond. The conversion right of CB is replaced by an attached warrant which warrants that holder can have a right to purchase shares at a certain (at premium) price. Investor can detach the warrant and sell it separately.

Interesting names:

Plain vanilla bonds: straightforward traditional bonds without any special features.

Yankee bonds: US dollar denominated bonds issued in US by non-US issuer.

Bulldog bonds: UK pound (Guilt) denominated bonds issued in UK by non-UK issuer.

Samurai bonds: Yen denominated bonds issued in Japan by non-Japanese issuer.

Sushi bonds: Yen denominated bonds issued in a Euro market by Japanese issuer.

Next issue I will continue to brief on debt instruments – foreign currency debts.