

## 1.) Why do corporations sell bonds?

Corporations have options to raising money without taking out a loan. You can issue corporate bonds. There is no limit as to how many you can sell or how often you can sell them. However, issuing bonds affect your corporation in substantially different ways. You have the benefit of reducing your tax liability without sacrificing control of your corporation.

For **ownership protection**, issuing bonds does not change your ownership percentage in your corporation. When you issue bonds, you are asking investors to loan your company money. Bondholders are your corporation's creditors but not the owners.

For **interest deduction**, bond debt works like every other type of corporate debt. The principal amount is a loan and does not increase your taxable income. You can deduct the interest payments make to bondholders on your corporate income tax return. This in turn reduces your taxable income and your tax liability.

For **fixed maturity date**, bonds have a finite life span. This lets you know in advance how much the corporation will spend paying interest and repaying the original loan. When the bonds reach their maturity date, your obligation to make interest payments ends. The bond issue is retired and removed from the corporate books

## 2.) What are the differences among a debenture, a mortgage bond, and a subordinated debenture?

A **debenture**, or unsecured, bond is not backed by property. The bond issuer's credit standing supports the promise that the bond's payment terms will be met. Debenture bonds are issued when a company does not have enough assets to serve as collateral. If a company is well established and has a high credit rating, issuing debenture bonds is an easy way for them to raise funds. Debenture bonds typically carry more risk than mortgage bonds and must pay a higher interest rate to investors. If a company liquidates, debenture bondholders are paid after mortgage bondholders.

A **mortgage bond** is a type of secured bond because the bond is backed by collateral. The collateral is usually real estate or some other type of property that is subject to a mortgage. In the event of a bond default, you can foreclose and sell the property tied to the bond to collect your investment. Due to their direct claim on company assets, a mortgage bond is a safer and higher quality investment with a lower risk of default than a debenture bond.

The main difference between mortgage bonds and debenture bonds is collateral. The mortgage bond is collateralized by something that has value and can be sold to pay the bondholders if the company defaults on payment of that bond or goes through bankruptcy. Debentures have no such collateralization. They are unsecured debt, backed only by the full faith and credit of the issuing company. If investors receive only the issuer's promise to pay, they typically require a higher interest rate than they would require to buy a collateral-backed bond.

**Subordinated debenture** is an unsecured bond with a claim to assets that is subordinate to all existing and future debt. Thus, in the event that the issuer encounters financial difficulties and must be liquidated, all other claims must be satisfied before holders of subordinated debentures can receive a settlement. Frequently, this settlement amounts to relatively little. Because of the risk involved, the

issuers have to pay relatively high interest rates in order to sell these securities to investors. Many issues of these debentures include a sweetener such as the right to exchange the securities for shares of common stock. The sweeteners are included so that interest rates on the subordinated debentures can be reduced below the level that would be required without them. Subordinated debentures without the conversion option appeal to risk-oriented investors seeking high current yields.

### 3.) Why would an investor purchase a convertible bond or a high-yield bond?

High-yield bonds are defined as debt obligations, popularly known as "junk bonds" or "below-investment grade". These bonds are available to investors as individual issues or through high-yield mutual fund investments. For the average investor, high-yield mutual funds are the best way to invest in junk bonds, as these funds were formed to diversify a pool of junk bonds and reduce the risk of investing in financially struggling companies. For the advantages of high-yield bonds, in the situation that many companies run into financial difficulty at various stages of their existence. One bad year for profits or a tragic chain of events may cause a company's debt obligations to be downgraded to a level below investment grade. Because of these additional risks, high-yield investments have generally produced better returns than higher quality, or investment grade, bonds. So, for the investors who are looking to get a higher yield within your fixed-income portfolio, high-yield bonds have typically produced larger returns than government bonds and highly rated corporate issued.

### 4.) Describe three reasons a corporation would sell convertible bonds?

The first reason companies prefer issuing convertible bonds has very much to do with **interest rates**. They can achieve their goal, obtaining capital to grow their business, at super low rates. Convertible bonds have lower yields than traditional corporate bonds. So they get to take the currently low interest rates and lower them even more by issuing convertible debt.

Another advantage of selling convertible bonds is that the **amount issued does not show up on the company's balance sheet as a debt**. Interest payments, unlike dividend payments, are federally tax deductible.

Finally, issuers sell convertible bonds to provide a **higher current yield** to investors and equity capital upon conversion. Investors buy convertible bonds to gain a higher current yield and less downside, since the convertible should trade to its bond value in the case of a steep drop in the common share price.

### 5.) Explain the methods that corporations can use to repay a bond issue?

There are two methods that the corporation is able to pay back bond issue. First, it is **sinking funds**. It is a company required to set aside funds in a saving account periodically to meet the amount that the company needs to repay the principal. Another method is **serial bonds**. It is a company issues bonds with different maturity at the same date in order that company can repay principal back in different time with divided amounts.