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**Individual Assignment (Due on 23$^{rd}$ April)**

## 1. Why do corporations sell bonds?

Issuing bonds in one way for the company to raise fund. The decision to issue bonds instead of choosing alternative options of raising money can be driven by many factors.

Firstly, comparing with borrowing from financial institution's option, the interest rate that the company pay to the bondholder is usually less than the interest rate it would be required to pay back to obtain the bank loan. It is one reason that even the corporation that does not seem to need the money decides to issue the bonds when the interest rate is very low, leading to low payment to the bondholders. Record keeping for bond is also simpler, because all bondholders get exact same deal with the same maturity and interest rate. Moreover, bank loan often comes with restriction, which may cause the company to have less freedom in its operation. The examples of some limitations are inability to issue more debts or involving in business acquisition during the period of borrowing.

Secondly, issuing stock means granting some parts of ownership in the firm to outsiders in exchange of money, reducing the role and right of existing shareholders while bond issuance does not. Even one of the most attractive feature of stock issuance is the fund generated from this way, which is usually large amount, does not need to be repaid to the investors, but the company need to trade-off with some advantages. The company is required to disclose the performance strategies and the financial analysis to public, which may lead to declining in profit of the company due to more bargaining power from both its suppliers and customers.

Therefore, the company will choose to raise money through bond issuance if and only if the benefits it gets from this option is better than benefits from other available alternatives.

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

A Debenture and a mortgage bond are types of debt instruments. However, the main difference between them is collateral because the mortgage bond is collateralized by something that has value and can be sold to pay back the bondholder if the company becomes bankrupt.

While, a debenture is another type of bond that does not pay collateral or otherwise is recognized as unsecured bond. Because of its riskiness, the companies that issue debenture should be profitable and believable that they can pay back the borrowed money and larger amount of interest compared to bond with collateral.

A subordinated debenture has similar characteristics, but it is usually paid in the subordinated issues. It is a type of junior debt or prioritized lower than other classes of debt in the case of liquidation. Because of its high risk, it normally pays higher interest rate to the holder other debt assets.

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

Convertible bond can be referred as a hybrid of stock-market excitement and bond security. The investors prefer to hold this to provide yields both in good times and bad times.

When the stock market is in a good condition, the stock price increases and the investor can take an advantage of convertible bond by converting it to stocks, sell them at satisfied level, and take the profit.

While during the downturn of the market, the investors can be offset by the periodic payment of coupon, which they would not get this benefit if investing in stocks solely. Moreover, there is a possibility that the stock will rise again and the investors can convert this high-yield bond to enjoy the profit.

**4. Describe three reasons a corporation would sell convertible bonds.**

Firstly, issuing convertible bonds can be referred as a delayed method of equity financing for the company because it provides an advantage of delaying the dilution effect of common stock and earning per share.

Secondly, the company is able to offer the bond at lower coupon rate compared to what it has to pay on the straight-issued bond. The more valuable the conversion feature, the lower yield that must be offered to sell the issue.

Thirdly, the company prefers to offer differentiated securities to take advantage of market conditions and lower its overall cost of capital below what it would be if the company issues only one class of debt and common stocks.

**5. Explain the methods that corporations can use to repay a bond issue.**

There are many ways for the company to repay a bond issue. Moreover, the company can choose the option of the source of fund for the repayment as well. The company can use its own money or relies on refunding. The refunding can be done by issuing new bonds or other financial instruments to repay the matured loans. This can be perceived as a postponement of debt redemption.

The first one is to paying only the principal (no coupon). The promised amount of face value will be paid to the bondholder on the maturity date.

The second one is repaying both coupon and principal. The company is required to pay the interest periodically to the bondholders as the cost of borrowing. However, the company can choose whether it will pay the coupon directly on the next period after getting the principal from the creditors or pause for some periods of time before start paying the coupon.

The third one is sinking fund method. The company will accumulate the amount of principal by setting aside some money continuously. This can assure the bondholders about the ability to pay back the face value at the time of maturity.