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1. Why do corporations sell bonds?

ANS: A corporation is type of business organization in which the business is legally separated from its owners. Corporations can raise fund in many ways by taking a loan from commercial bank that can be more costly or more expensive, by selling shares of stocks or by selling bonds like a government. Selling bonds which have the specific maturity or the finite time, this will help the corporation to know in advance their cashflow of when they have to pay the return to the bondholders. Selling bonds benefits corporation in the tax liability reduction and also there is no need to trade off some of the control or the ownership since the bondholders have no rights to vote on corporate issue. It has callable feature that has the right to call the bonds in before their maturity date. Furthermore, when the corporation be sued or have financial problems, only corporate assets can be seized.

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

ANS: These three are all considered as bonds. However, they all are different types of bonds with different characteristics as follows;

Debentures have a more specific purpose than bonds. It is not secured by physical assets or collateral. They are typically issued to raise short-term capital for upcoming expenses or to pay for expansions. Sometimes called revenue bonds because they may be expected to be paid for out of the proceeds of a new business project, debentures are never asset-backed and are only backed by the credit of the issuer. They are backed only by the general creditworthiness and reputation of the issuer. Both corporations and governments frequently issue this type of bond in order to secure capital. Like other types of bonds, debentures are documented in an indenture.

Mortgage bond is a bond secured by a mortgage on one or more assets. These bonds are backed by real estate holdings and/or real property such as equipment, house, cars and others. In a default situation, mortgage bondholders have a claim to the underlying property and could sell it off to compensate for the default. It is typically a long-term bond secured by the payments on one or more mortgages. Bondholders have the right to take possession of and sell the property underlying the mortgage in order to recover their investments.

Subordinated debenture, it is an unsecured bond that in the event of liquidation. It is a loan (or security) that ranks below other loans (or securities) with regard to claims on assets or earnings. It is also known as a "junior security" or "subordinated loan which is prioritized lower than other classes of debt. It has no collateral. When the issuer be liquidated, all other bonds and debts must be repaid before the subordinated debenture bond is repaid. This class of debt carries higher risk, but also pays higher interest than other classes.

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

ANS: Convertible bonds, or converts, give the holder the option to exchange the bond for a predetermined number of shares in the issuing company. Investors buy this kind of bond because of the advantages, one of several advantages of this delayed method of equity financing is a delayed dilution of common stock and earnings per share (EPS). Another is that when first issued, they act just like regular corporate bonds, with a slightly lower interest rate. Because convertibles can be changed into stock and thus benefit from a rise in the price of the underlying stock, companies offer lower yields on convertibles. If the stock performs poorly there is no conversion and an investor is stuck with the bond's sub-par return (below what a non-convertible corporate bond would get). As always, there is a tradeoff between risk and return.

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

ANS:

1.) A corporation issues a convertible bond to take advantage of reduced interest rates, since the presence of the conversion option provides upside potential for the bondholders, and these bonds tend to demand lower interest rates compared to standard nominal bonds.

2.) Because it is when convertible bondholders only receive a relatively small, fixed income, this means that more income is available to the common stockholders until the bonds convert to stocks. This also allows common stockholders to temporarily maintain voting control of the corporation while using the investment income from the convertible bondholders.

3.) Issuing convertible bonds helps a corporation to protect equity financing in a delayed manner, as it takes time for the bondholders to trade their bonds for stock. This process delays the common stock and earnings per share dilution.

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

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ANS: In order to make sure that a company is able to pay back, there are two methods;

1. A corporation needs to set aside funds in a saving account, which is called sinking funds, in order to ensure that the corporation will be able to repay the principal back.
2. The corporation can issue serial bonds, which are bonds with different maturity at the same date, this helps a corporation can repay principal back in different time with divided amounts.