

# 650 questions 11 and 12

Finance



650 questions 11 and 12 Bond Selection Answer 6 A make-whole provision of the bonds of the company is where the borrower is allowed to clear out the residual debt early. For this provision to become effective the borrower needs to pay a lump sum amount to the holder depending on the NPV (Net Present Value) of the coupon payments not paid earlier due to call. Through the option of make whole the investors are compensated to the amount of the current value of the debt based on the prevailing spread over the current benchmark related to the company. Moreover as per the contract of debt the amount compensated for is greater than the fair value as stated in the contract. This provision is made in the marketable bonds so as to attract the investors. If at any point of time the provisions regarding the make whole call are ever invoked then the bondholder is subject to a lump sum payment much earlier than anticipated. Thus investors are usually made whole with the make whole call provision (Capital Advisors Group, Inc., 2004, p. 1).

Answer 7

The regular bonds of the company bears the interest payment which is usually absent in case of a zero coupon bonds. Again the bond holder of a zero coupon bond receives only the face value of the bond at its maturity. However the regular bondholder receives the coupon paid over the life of the bonds along with the face value of the bond. Thus it is better to opt for the regular bond of the company as the distribution of interest of the bond may change as per the market condition but such a probability is not available in case of the zero coupon bond.

Under the typical call option facilitates the issuer to gain advantage through the prepayments of debt with the decline in the market yields. In case of settlement the ordinary call option is usually less than the fair value of the

debt. Contrarily, the make-whole call option is obtained through the discounting of the remaining contract of the debt at an appropriate treasury rate. Thus it is always better to opt for the make-whole call than an ordinary call as the advantage at the time of settlement is more for make-whole than ordinary shares.

International

Answer 5

The company should not pursue international sales further because if the financial exposures of the company results in the exchange rate rising from \$0.73/€ to \$0.80/€ it may tend to be cause of dilemma for the company. With the rise in the exchange rate the cost of the product will also raise leading to the increase in the prices of the product. As per the law of demand, the rise in the prices of the product leads to decrease in its demand. Further the company has plans of spending 70% of the sales income on the production which will get highly hampered due to the financial exposures of the company. But if the company can employ hedging instruments to diversify the financial risk of the company then perhaps there may be ways of dealing with international sales; not otherwise.

Reference

Capital Advisors Group, Inc., 2004. Make-Whole Call Provisions. Retrieved from: .