Bond Characteristics

- Term of a bond is usually for more than one year
- Bonds are approved by the board and the shareholders
- Bonds are governed by covenants stated in the bond indenture
  - Amounts authorized
  - Interest or coupon rate
  - Due date or dates
  - Call provisions (company may elect to call and retire bonds at a certain price and under certain conditions)
  - Property pledged as security
  - Sinking fund requirements (fund to pay off the bonds)
  - Working capital and dividend restrictions
    - Working capital is the current assets less current liabilities
    - Restrictions on dividends safeguards the ability to pay bonds
  - Limits on assuming new debt
- Issuance of bonds
  - Investors buy bonds in small denominations ($1000)
  - Bond indenture is a contract to pay a sum of money at a designated date with periodic interest payments
  - Some bonds are underwritten (sold to investment bankers who guarantee a certain sum to corporations and take the risk of selling to their clients at whatever price they can get)
  - Best efforts sell for commission, deducted from the proceeds
  - Others for private placement (sell directly to large institutions)
- Types and Ratings
  - Secured bonds are backed by collateral
    - Mortgage bonds have a claim on real assets
    - Collateral trust bonds are backed by other corporations
  - Unsecured are not backed by collateral and are called debenture bonds. Some of these are junk bonds, used for leveraged buyouts
  - Term bonds mature on a single date
  - Serial bonds mature in installments (for schools, municipalities)
  - Callable bonds give the issuer the right to call and retire the bond
  - Convertible bonds are commodity backed and deep discount
    - Linked to assets such as coal, oil and steel
    - Deep discount are zero coupon: one payment at maturity
  - Registered bonds: are issued in the name of the owner
  - Bearer bonds: have no recorded name and are transferred by delivery
  - Income bonds: no interest unless the company is profitable
  - Revenue bonds: interest and principle paid from a revenue source
- Issuers and classes of bonds
  - US government
    - T-bills are under one year maturity
    - T-notes are under 10 years maturity
    - T-bonds are longer maturity
  - Municipal issues federal and state tax-free bonds
  - Corporate bonds are rated by Moody’s and Standard and Poor’s
  - Commercial Paper is short term financing by businesses
  - Mortgages are securitized debt