Understanding Convertible And Reverse Convertible Bonds

The issuer or buyer issues bonds to the creditor. If the market value of the collateral or amount of the bond increases, then the value of the convertible bond also goes up. If the value of the material on which the bond has been issued decreases, the bond will decrease in price. Convertible and reverse convertible bonds are similar with the exception of the role played by the underlying company.

Convertible Bonds

Convertible bonds are, as the name suggests, convertible. You can change them into another kind of bond or equity at a certain time, and within certain limits. You must remember that the convertible bond has some value apart from what the conversion feature gives it. Many companies that deal in bonds prefer the convertible bond, as its flexibility means that it can be converted into equity, reducing the cash burden on the company. That is, if the issuers of the bond decide to convert their bonds, then they simply buy the shares of the issuing company.

Reverse Convertible Bonds

Reverse convertible bonds are similar to convertible bonds except in one feature. While the convertible bond allows the issuer to invest more in the issuing company, the reverse convertible bond allows the issuer to hold shares in the company. The advantage reverse convertible bonds have over convertible bonds is that they are more profitable and mature in a shorter amount of time.

For example, consider a bond issued by a bank to cover what it owes in debts to a company. The bond may yield substantial amount through shares, but if the company's shares decrease in value, then the bank can put up the shares of the company to the party that holds the bond. In that case, the bank need not pay cash during the time of the bond's maturity.

Conversion Ratio

The conversion ratio refers to the number of shares that can be converted from a bond into another form of debt or equity. This is specified at the time of the issuance of the bond.

Risk

Convertible bonds, like all bonds, carry a risk option. While companies give lower yields on convertible bonds, the issuer can benefit from an increase in the stock value of the company and convert the bonds to shares. However, if the company's stock decreases in value, then the issuer has a low yield bond on his hands.

Additional Help

If you are unsure of the dynamics of the convertible bond according to the market, or want to know more about how they work, you can approach any financial consultant for help. If you are an entrepreneur or run a small-scale business, then it is crucial that you know about the options you possess, regarding convertible and reverse convertible bonds. Many small-scale business consultants can help you decide your bond options. It should be remembered that while convertible and reverse convertible bonds have certain risks, they also yield high returns if you invest wisely.

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