

Difference Between Callable and Convertible Bonds

www.differencebetween.com

Key Difference - Callable vs Convertible Bonds

A [bond](#) is a debt instrument issued by corporates or governments to investors in order to obtain funds. They are issued at a par value (face value of the bond) with an [interest rate](#) and a maturity period. Callable and convertible bonds are two popular types of bonds among many. The key difference between callable and convertible bonds is that **callable bonds can be redeemed by the issuer prior to maturity** whereas **convertible bonds can be converted into a predetermined number of equity shares during the life of the bond**.

What are Callable Bonds?

Callable bonds, also referred to as **redeemable bonds**, are a bond that can be redeemed by the issuer prior to maturity (final payment date). Bonds can have maturity periods ranging from short, medium to long-term; some bonds have maturity periods exceeding 10 years. With fluctuations in interest rates over time, if the rates have decreased since the company first issued the bond, the company will want to refinance the debt at a lower rate of interest. As a result, the company may decide to call the issued bonds and reissue them at a lower interest rate.

Not all types of bonds are callable, especially [treasury bonds](#) and [notes](#). Most municipal bonds and some corporate bonds are callable. Companies must specify whether their bonds are callable at the time of issuance. Other related information such as whether there is a possible [call option](#) in the future should be specified at the outset. When a bond is callable, it takes place at a premium (at a higher price than the issue price).

E.g. In 2015, ABC Company issued a callable bond for a price of \$ 100 with a maturity period of 3 years at an interest rate of 7%. By 2017, interest rates declined to 5% which tempted the company to recall the bond. The call option will happen at a price of \$ 103.

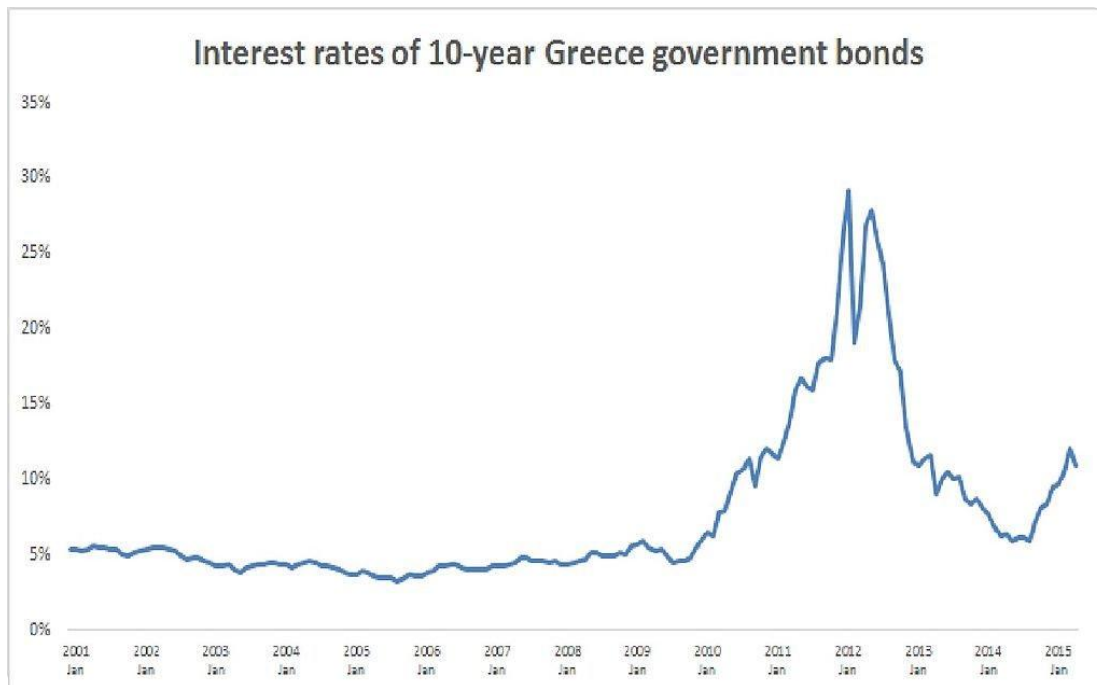


Figure 01: Interest rate fluctuations is the main reason for issuers to recall the bonds

What are Convertible Bonds?

Convertible bonds are debt instruments that can be converted into a predetermined number of [equity shares](#) during the life of the bond. It is an option, not an obligation for the investor to exercise the conversion. For how many numbers of shares that the bond will be able to be converted to is decided through the ‘conversion ratio’.

E.g. DEF Company issues a bond at a par value of \$ 1,000 at a coupon rate of 5% with a maturity period of 4 years. The conversion ratio is 20. This means that the investor is effectively purchasing 20 shares of DEF for \$50 per share ($\$ 1000 / 20 = \$ 50$). The share price of DEF is rising continuously and is at \$ 67 following two years of the bond issue. Thus, the investor decides to exercise the conversion where he gains 20 shares worth \$ 67 per share.

Convertible bonds are a popular type of debt investment among investors due to its flexibility. At the time of the issuance of the bond, the bondholder does not know how the share price of the company will fluctuate within the time frame of the bond. If the share price appreciates, the bond holder will be willing to become a shareholder of the company and will convert the bond into equity shares. If the share prices do not show positive growth or are declining, the bond holder can terminate the relationship with the company by only receiving the principal and interest of the bond at the end of maturity. Therefore, convertible bonds minimize the downside of the investment since the bond can be left to mature if the company is less successful or unsuccessful, and maximize the upside if the company is successful by converting the bond to shares.

What is the difference between Callable and Convertible Bonds?

Callable vs Convertible Bonds	
Callable bonds are bonds that can be redeemed by the issuer prior to maturity.	Convertible bonds are debt instruments that can be converted into a predetermined number of equity shares during the life of the bond.
Conversion Option	
Callable bonds cannot be converted into equity shares.	Convertible bonds can be converted into ordinary shares upon the discretion of the bondholder.
Beneficial Party	
Callable bonds are a lucrative investment to companies since they can reissue debt at a lower interest rate.	Convertible bonds are beneficial from the investors' point of view since it gives the option to become future shareholders of the company at their discretion.

Summary- Callable vs Convertible Bonds

The difference between callable and convertible bonds are a discrete one ; if a bond is issued with an option to redeem before maturity, it is called a callable bond and if a bond is issued with an option to convert it to a number of ordinary shares at a future date, it is called a convertible bond. Which type of bond to invest in mainly depends on the nature and expectations of the investors; for instance, callable bonds are not an appealing option for an investor who requires a steady income.

References:

- 1."What Is a Callable Bond? - TheStreet Definition." TheStreet. N.p., n.d. Web. [Available here](#). 01 June 2017.
- 2."Convertible Bond." Investopedia. N.p., 23 Jan. 2014. Web. [Available here](#). 01 June 2017.
- 3."Convertible Bond." Investing Answers Building and Protecting Your Wealth through Education Publisher of The Next Banks That Could Fail. N.p., n.d. Web. [Available here](#). 01 June 2017.

Image Courtesy:

1. "Greece gmnt bonds" By Verbal.noun at English Wikipedia ([CC BY 3.0](#)) via [Commons Wikimedia](#)

How to Cite this Article?

APA: Difference Between Callable and Convertible Bonds. (2017, June 07). Retrieved (date), from <http://www.differencebetween.com/difference-between-callable-and-vs-convertible-bonds/>

MLA: "Difference Between Callable and Convertible Bonds." *Difference Between.Com*. 07 July 2017. Web.

Chicago: "Difference Between Callable and Convertible Bonds." *Difference Between.Com*. <http://www.differencebetween.com/difference-between-callable-and-vs-convertible-bonds/> (accessed [date]).



Copyright © 2010-2017 Difference Between. All rights reserved.