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Determinants of bond tender premiums and the percentage tendered

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Abstract

We analyze a large sample of US corporate bond tender offers to understand what affects tender premiums as well as the percentage of bonds tendered. For the average (median) tender offer, the tender price is 5.55% (3.24%) greater than the pre-tender market price while the percentage of bonds tendered is 82.3% (94.6%). Premiums offered by firms are greater when the firm is simultaneously soliciting consents to amend restrictive covenants and when the bond has a greater number of restrictive covenants. Premiums are also greater when long-term risk-free yields are low and the yield curve is flatter – conditions where a firm might want to lock in favorable long-term rates by issuing new debt and retiring old debt. Bondholders respond to higher tender premiums by tendering a greater percentage of their bonds – a 1% increase in tender premium increases the tendering rate by approximately 9%. Bondholders also tender a greater percentage of bonds possessing less desirable characteristics such as a short remaining maturity or bonds that are simultaneously undergoing consent solicitations. Finally, we find that tender offers are easier to complete when bond ownership concentration is greater.

JEL classification: G32; G34

Keywords: Debt; Bonds; Tender offer; Repurchase; Restructure

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1. Introduction

When structuring new debt issues, firms must decide on issue size, maturity, seniority, and whether to include a host of potentially restrictive covenants. Every decision entails a tradeoff. For example, choosing long-term debt locks in interest costs for an extended period. However, if interest rates drop, long-term debt loses its appeal. Similarly, restrictive covenants will generally reduce a firm's borrowing cost due to a reduction in agency conflicts (Bradley and Roberts, 2004). By definition, however, restrictive covenants may inhibit the firm's ability to make optimal decisions in the future.

Fortunately, few capital structure decisions are irreversible. Thus, an important factor in any of these tradeoff generating decisions is at what cost can they be reversed? Including a call feature is one way that firms enhance their ability to retire debt early and undo prior capital structure decisions. Callable bonds, however, have significantly higher yields on average (see e.g., Kish and Livingston, 1993 for fixed-price call provisions and Mann and Powers, 2003 for make-whole call provisions). Because of this tradeoff, many corporate bonds are non-callable. As of 12/31/2003 for example, the Fixed Income Securities Database (FISD) indicates that 46% of US corporate bonds outstanding were not currently callable.[1] Firms have other tools, however, for extinguishing debt prior to stated maturity – at any time, firms can tender for their existing bonds regardless of whether the bonds are currently callable.[2] Thus, to understand the tradeoffs inherent in other capital structure decisions, it is vital to have a comprehensive understanding of bond tender offers.[3]

The importance of understanding bond tender offers is highlighted by the fact that they are relatively common. For example, the dataset for this study is comprised of 943 debtor-initiated corporate bond tender offers initiated between 1/1/1997 and 12/31/2003. The total face value of bonds repurchased via these tender offers was approximately $153 billion. In comparison, the called bond data in the FISD indicates that over the same period of declining interest rates, 1396 fixed-price call provisions were exercised, retiring approximately $160 billion in total face value.

While a substantial body of literature exists that addresses multiple aspects of call provisions, relatively little empirical evidence exists regarding the details of debt tender offers. Wingler and Jud (1990) analyze stock price reactions to debt tender offer announcements but provide little information about actual tender offer transactions. Kahan and Tuckman

[1] A detailed breakdown of outstanding bonds is as follows: non-callable: 28%, fixed-price call but currently call-protected: 18%, fixed-price call and currently callable: 31%, make-whole call and currently callable: 23%.

[2] When executing a tender offer, the firm announces a desire to buy back specified debt issues. The tender might be for a fixed dollar amount representing a fraction of outstanding face value, or more commonly, for "any and all" of the targeted issues. An offering circular is mailed to bondholders-of-record detailing the price that the firm is willing to pay and the time window during which bondholders can tender their bonds – the firm can increase the tender price and/or lengthen the tender window if participation is lower than desired. At expiration, all participating bondholders tender their bonds in exchange for the same cash payment from the firm.

[3] Make-whole call provisions have been characterized as a cap on the price of a successful tender offer (Mann and Powers, 2003). Thus, understanding the potential cost of a tender offer is a particularly critical element in deciding whether to incorporate a make-whole call provision in new debt. See Powers and Tsyplakov (2006) for an analysis of make-whole call provision pricing that incorporates the benefit of avoiding potentially costly tender offers.