# Convertible bonds

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# Principles

- Investment vehicles that are part bond and part equity
  - Interest of some investors only in the bond part
  - Interest of other investors only in the equity part
  - However, interest of most of them because it can be bond one day and equity another
- Unawareness on what sort of vehicle they will end up
- Decision to convert in the hands of the bond's holder who has 2 possibilities
  - Turn the bond into equity at any time
  - Let the bond run to expiry and take a cash lump, just like a straight bond = redemption option
- Attractivity of the bond floor's feature in times of bearish market

# Features

- Conversion period
  - Defined in the prospectus
  - Generally from issuance date onwards to redemption date
  - Possible early redemption if the CB is issued with a call provision
- Conversion ratio
  - Number of shares to be obtained if the bond is converted
  - Adjusted in the case of capital increases or decreases, mergers, exceptional dividends, so that the bond holders rights are unchanged, as if they had been shareholders since the bond's issue
- Premium
  - Additional cost per share assuming an immediate conversion of the bond
- Call
  - Extra option - for the issuer - embedded in the instrument
  - Right for the issuer to « call back » the CB at a predesignated price
  - In general, fair degree of warning when an issuer's call is about to be triggered
  - Possibility for the bond holder to convert the bond
  - Customary conditions
    - Share price > 130% conversion price
    - Min 3 to 5 years after the instrument' issue
- Put
  - Possibility for the holder to force the issuer to buy back the instrument earlier
  - Influence of the put when share prices are low

| | |
|---|---|
| Nominal value | 5 000 |
| Conversion price | 8,00 |
| **Conversion ratio** | **625** |
| Coupon | 0 |
| Underlying share price | 7,80 |
| Dividend yield | 1% |
| Time to maturity (year) | 1 |
| Quoted market price at issue | 103 |
| | |
| Convert bond's price at issue | 5 150 |
| Selling price of shares if conversion | 4 875 |
| Loss if conversion | -275 |
| **Premium** | **275** |

| | |
|---|---|
| **With a call provision** | |
| Share price | 10 |
| Selling price of shares if conversion | 6 250 |
| Bond's quoted market price | 125 |
| | |
| Call notice | 102 |
| Selling price | 5 100 |
| Value per share | 8,16 |
| | |
| Overnight loss per share | -1,84 |
| ie in % | -23 |
| Total loss | -1 150 |
| Solution: convert | |

# Terminology

- Expression of everything as a % of the nominal amount
- Intrinsic value = parity
- Excess cash value = premium
  - Barely in cash-value terms
  - In general as a % over parity

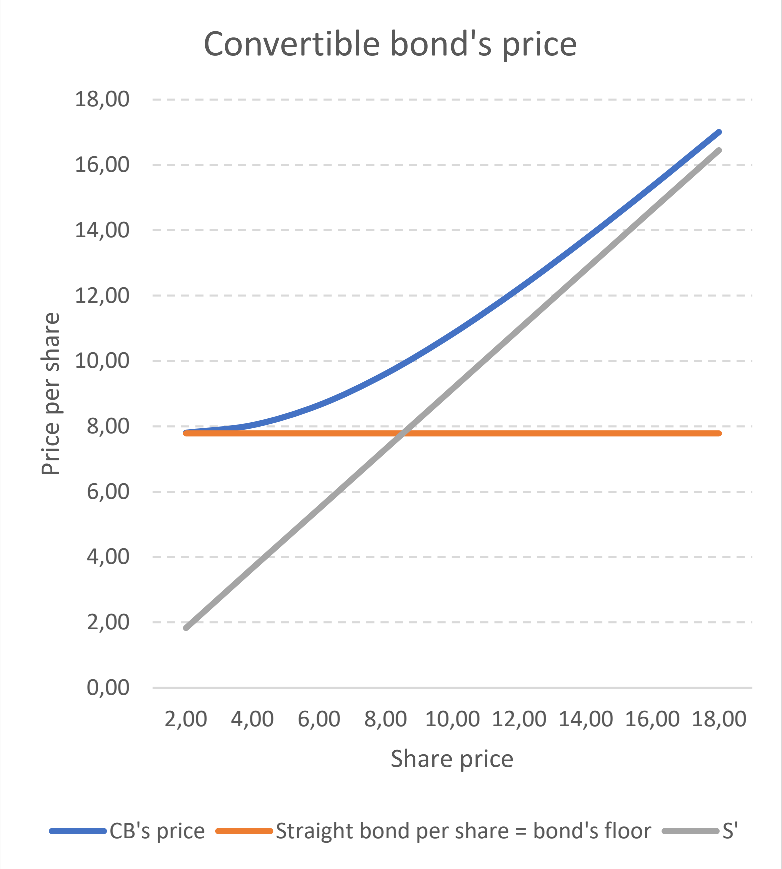
| | **Cash value** | **Market quote on bond points** | **Value per share** |
|---|---|---|---|
| Nominal value | 5 000 | 100,00 | 8,00 |
| Conversion price | 8,00 | 100,00 | 8,00 |
| Conversion ratio | 625 | | |
| Coupon | 0 | 0,00 | 0,00 |
| Parity | 4 875 | 97,50 | 7,80 |
| Price at issue | 5 150 | 103,00 | 8,24 |
| Premium | 275 | 5,50 | 0,44 |
| Premium as a % | 5,64% | 5,64% | 5,64% |

# Placement in the market

- Accelerated Book Building (ABB)
  - Limited communication efforts
  - Low or no management's involvement
  - Timeline: a few hours
- Bought deal with back-stop
  - Purchase of the convert bonds by a bank
    - Choice of the bank based on its price proposal that is awaited within a few hours
    - Immediate sale of the securities to the bank which starts the placement in the US then in Japan
  - Higher discount compared to ABB's conditions
  - Minimum guaranteed price (back-stop) for the placement; substitution of the bank to investors if demand based on the guaranteed price is not enough
- Availability of information disclosed to shareholders
- Low asymmetry of information as the bond holder is protected by the bond's floor

# Value = straight bond + option to convert

- At high prices of the share, CB's price nearer and nearer the parity line
  - Behaviour of the CB's prices like a package of shares
  - Opportunity for the holder to enjoy all or most of the benefits of a rising market
- In the case of share price fall, fall of the CB's price but at a lower rate
- At very low share prices, CB's price flattened out to constant level as the redemption, rather than the conversion option, will be invoked




| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Nominal | 1000 | | | | | | | | |
| Life | 3 | | | | | | | | |
| Coupon rate | 5% | | | | | | | | |
| Yearly coupon | 50 | | | | | | | | |
| Ref rate | 6% | | | | | | | | |
| Straight bond value = bond floor | 973,27 | 973,27 | 973,27 | 973,27 | 973,27 | 973,27 | 973,27 | 973,27 | 973,27 |
| Conversion ratio | 125 | 125 | 125 | 125 | 125 | 125 | 125 | 125 | 125 |
| Straight bond per share = bond's floor | 7,79 | 7,79 | 7,79 | 7,79 | 7,79 | 7,79 | 7,79 | 7,79 | 7,79 |
| | | | | | | | | | |
| Implied share price ('E) | 8,00 | 8,00 | 8,00 | 8,00 | 8,00 | 8,00 | 8,00 | 8,00 | 8,00 |
| Spot price of the share (S) | 2,00 | 4,00 | 6,00 | 8,00 | 10,00 | 12,00 | 14,00 | 16,00 | 18,00 |
| Dividend yield: δ | 3% | 3% | 3% | 3% | 3% | 3% | 3% | 3% | 3% |
| S' | 1,83 | 3,66 | 5,48 | 7,31 | 9,14 | 10,97 | 12,80 | 14,62 | 16,45 |
| Volatility | 40% | 40% | 40% | 40% | 40% | 40% | 40% | 40% | 40% |
| Time to expiration | 3 | 3 | 3 | 3 | 3 | 3 | 3 | 3 | 3 |
| Risk free rate | 1% | 1% | 1% | 1% | 1% | 1% | 1% | 1% | 1% |
| d1 | -1,74 | -0,74 | -0,16 | 0,26 | 0,58 | 0,85 | 1,07 | 1,26 | 1,43 |
| d2 | -2,43 | -1,43 | -0,85 | -0,43 | -0,11 | 0,15 | 0,37 | 0,57 | 0,74 |
| F(d1) | 0,04 | 0,23 | 0,44 | 0,60 | 0,72 | 0,80 | 0,86 | 0,90 | 0,92 |
| F(d2) | 0,01 | 0,08 | 0,20 | 0,33 | 0,46 | 0,56 | 0,65 | 0,71 | 0,77 |
| Option premium | 0,02 | 0,25 | 0,86 | 1,82 | 3,04 | 4,43 | 5,95 | 7,56 | 9,22 |
| | | | | | | | | | |
| CB's price | 7,80 | 8,04 | 8,65 | 9,61 | 10,82 | 12,22 | 13,74 | 15,34 | 17,01 |

# Accounting in the IFRS environment

- Balance sheet
  - Value of the option to convert
    - Booked in equity
    - Amount definitively fixed
  - Value of the debt
    - Booked in the financial debt
    - Revalued every year
    - Implied yearly amortisation of the difference between the par value of debt and its initial book value (BV)
      - Initial BV of debt = sum of present values of cash flows (interests and instalments) based on a « normal » discount rate for such a debt
- Income statement
  - Interests
  - Amortisation that corresponds to the yearly revaluation of debt
  - Implied normal cost of debt

## 22.1 Net debt

The variations in net debt are broken down as follows:

| 31 December 2019 | Cash impact | Cash Impact: Increase | Cash Impact: Decrease | Cash Impact: Interest and commission paid | Without cash impact: Issuance fees | Without cash impact: Interest | Without cash impact: Change effect | 31 December 2020 |
|---|---|---|---|---|---|---|---|---|
| Cash at bank and in hand | 94,472 | 202,115 | - | - | - | - | - | 296,587 |
| Short term investments & cash equivalent | 16 | 132 | - | - | - | - | - | 148 |
| **Total Cash and cash equivalents** | **94,488** | **202,247** | **-** | **-** | **-** | **-** | **-** | **296,735** |
| Convertible bond | 182,075 | - | - | (251) | 250 | 4,411 | - | 186,485 |

| (in € thousands) | 31 December 2019: EUR | CHF | GBP | USD | Others currency | Total |
|---|---|---|---|---|---|---|
| Convertible bond | 182,075 | - | - | - | - | 182,075 |
| Term loan | 49,810 | - | - | - | - | 49,810 |
| Revolving Credit Facilities | (407) | - | - | - | - | (407) |
| Other borrowings | 904 | - | - | - | - | 904 |
| Deposits and guarantees | 745 | - | - | 45 | - | 790 |
| Banks overdrafts | 11 | - | - | - | - | 11 |
| Cash and cash equivalents | (82,880) | (4,077) | (1,198) | (5,764) | (568) | (94,488) |
| TOTAL NET DEBT | 150,258 | (4,077) | (1,198) | (5,719) | (568) | 138,695 |

The net debt lists the following credit facilities:

### a) Convertible Bond

On 6 December 2017, Maisons du Monde issued bonds convertible into new or existing shares (OCÉANE) due December 2023 by way of a private placement to institutional investors, for a nominal amount of €200 million (4,100,041 bonds with a nominal value of €48.78). Existing shareholders of the Company shall have no preferential subscription rights (or priority subscription period) in connection with the bonds or the underlying shares of the Company.

The Bonds have been issued at par and bear interest at an annual rate of 0.125%, payable annually in arrears on 6 December of each year and for the first time on 6 December 2018. Issuance fees were €2.3 million.

Unless previously converted, exchanged, redeemed, or purchased and cancelled, the Bonds will be redeemed at par on 6 December 2023. The Bonds may be redeemed prior to maturity at the option of the Company, subject to certain conditions, and at the option of the holders in the event of a change of control of the Company.

From the Issue Date (*i.e.* 6 December 2017) and up to 5.00pm. (Paris time) on the 7th business day preceding the maturity date or the relevant early redemption date, the Bonds will entitle their holders to receive shares of the Company at a ratio of one share per Bond, subject to any potential subsequent adjustments.

The Bonds are listed on the Euronext Access™ market of Euronext Paris since 12 December 2017.

The General Meeting of 12 June 2020 decided not to distribute a dividend in respect of 2019 results. Therefore, the ratio conversion/exchange was the same.

According to the stipulations specified in Article 2.6. (B).10 of "Terms & Conditions" related to OCÉANE, the Conversion/Exchange Ratio is maintained as of 4 July 2019 for 1,012 shares Maisons du Monde S.A. for 1 OCÉANE (up to three decimals and rounded to the nearest thousandth).

The market rate used and the initial breakdown between the "Debt" portion and the "Equity" portion are as follows:

- market rate used for the calculation of the debt: 2.35%;
- fair value of financial debt at issue: €173.3 million (net of €2.1 million issuance fees);
- equity portion of the convertible bond: €24.3 million (net of €0.3 million issuance fees).

As of 31 December 2020:

- the amount of the convertible bond, net of issuance fees, is €186.5 million;
- effective interest rate stands at 2.55% and the financial expense amounts to €4.7 million (debt accretion effect using the effective interest rate method).

# Convertible bonds and financial theory

- Conflicts resolution between shareholders and lenders
  - Management temptation to undertake risky investments to increase shareholders' wealth at the expense of lenders
  - Convertible bonds to be looked upon as the great issue to finance the levered firm as it provides the lender with the possibility to become a shareholder
  - Attractivity of convertible bonds given their low nominal rate and its possible placement on the market without a rating
- Conflicts resolution between managers and shareholders
  - Management temptation to get perquisites at the expense of shareholders
  - Convertible bonds to be looked upon as a tool to discipline managemers as suboptimal decisions and implied low share price are likely to drive to bond's redemption in cash, implying an increased risk of defaut
- Signal
  - Capital increase to be looked upon as the signal of share's overvaluation sent to the market
  - Unwillingness of fast growing firms to increase capital given their perception of share undervaluation
  - Convertible bonds to be looked upon as the best instrument to finance such firms and viewed by a debt, rather than equity by investors

# Non dilutive cash settled convert bonds

- Cash payment by the issuer should the conversion right be exercised
- Amount to be paid by the issuer = market value of the shares that would have been obtained assuming an issue triggered by the conversion
- No share issue and therefore no dilution
- Hedging via the purchase of calls on the issuer shares

# Example: Carrefour non dilutive convert

**Carrefour places US$500 million non-dilutive cash settled convertible bonds**

Carrefour announces today the placement of US$500 million non-dilutive cash-settled convertible bonds with a maturity of 6 years due 2024 (the "**Bonds**"). Concurrently, an affiliate of Carrefour is purchasing cash settled call options over Carrefour shares (the "**Call Options**") to hedge the economic exposure of Carrefour to pay cash amounts under the Bonds upon any exercise of conversion rights by investors. As the Bonds will only be cash settled, they will not give right to any new or existing Carrefour shares.

The Bonds will be issued at 96.75% of their nominal value on March 27, 2018, the expected settlement-delivery date of the Bonds, and redeemed at par on March 27, 2024. The Bonds will not bear interest (zero-coupon). The nominal value of each Bond will be US$200,000.

The initial conversion price (the "**Initial Conversion Price**") will represent a conversion premium of 20% over the share reference price. The share reference price (the "**Share Reference Price**") will be determined as the arithmetic average of Carrefour's daily volume-weighted average share price in euros on the regulated market of Euronext in Paris over the 10 consecutive trading days from March 23, 2018 (inclusive) to April 9, 2018 (the "**Reference Share Price Period**"). The initial conversion ratio of the Bonds will be determined on April 9, 2018, and will correspond to the nominal value per Bond converted in euros and divided by the Initial Conversion Price (the "**Initial Conversion Ratio**").

The net proceeds of the issue of the Bonds will be used for general corporate purposes and for the purchase of the Call Options.

It is anticipated that the hedge counterparties to the Call Options will enter into transactions to hedge their respective positions under the Call Options through the sale, purchase of Carrefour shares or any other transactions, on the market and off-market, at any time, and in particular during the Reference Share Price Period and at or around the conversion or redemption of the Bonds.

The Share Reference Price, the Initial Conversion Price and the Initial Conversion Ratio will be announced through a final press release at the end of the Reference Period, expected to take place on or around April 9, 2018.

Carrefour intends to apply for the Bonds to be admitted to trading on the Euronext Access™ (previously Open Market (*marché libre*) of Euronext Paris).

- Announcement of Carrefour share price reference on 04/09/20218: €16.7313
- Initial conversion price = €16.7313 x 1.2 = €20.0776
- FX rate: €1 = $1.23229
- Par value per bond in € = $200,000/1.23229 = 162,299.4587
- Initial conversion ratio = 162,299.4587 / 20.0776 = 8,083.6085 Carrefour share for 1 CB