

Bond Terminology

- Bond Covenants: Clauses to protect the bondholders' interests
- Bearer Bonds: The bond holder must present/send the certificate to claim the payments (interest and principal)
- Foreign Bonds: Bonds sold in foreign markets denominated in that country's currency (to local investors in that place) ... Ashok Leyland FCCB's and other FCCB's are examples

Hedging

- All firms have non-financial risk: Business Risk
 - Goal is to reduce it (ideally, eliminate it)
 - How?
 - Hedging & Forward/ Futures contracts
 - Hedging involves taking one risk to offset another risk
 - Example – Levers (Tea), Hindalco (Aluminium), Arvind Mills (Cotton), Ahmed Oil Mills (Refined Oil), Nestle (Coffee)
 - Forecasted income & sales volume is set by using a fixed selling price
 - Changes in cost can impact these forecasts

Hedging - Commodity Futures

- If you are Lever's tea procurement manager and you like today's 'unblended tea' prices
- To fix Lever's 'unblended tea' costs, you would ideally like to purchase all the raw tea requirement today. But, you cannot.
- You can, however, sign a contract to purchase tea at various points in the future for a price negotiated today
- This contract is called a 'Forward Contract'
- Technique is called 'Hedging'

Hedging

- Spot Contract – is a contract for an immediate sale and delivery of an asset
- Forward Contract – is a contract between two parties for the delivery of an asset at a negotiated price on a set date in the future
- Futures Contract – is a ‘Forward Contract’ *plus* there is an ‘intermediary’ that creates a standardized contract. Thus, the two parties do not have to negotiate the terms of the contract
- So, think of Hindalco making a deal in London Metal Exchange. LME guarantees all trades and provides a secondary market.

Types of Futures

Commodity Futures – Crude Oil (Dubai), for most farm products (Chicago), Soya (Indore), Castor Oil (Mumbai), Cotton (Ahmedabad), for most metals (London) ...

Similarly, you have ...

Financial Futures – 

- Foreign Currency (on Exchange Rate)
- Common Equity Shares (of Blue Chips),
- Index Futures – Nifty Futures (Spot 5933, March 5968), Sensex Futures

Futures Contract Concepts

- Not an actual sale
 - Always a winner & a loser
 - Hedge – You use it to eliminate risk by locking in prices
 - Speculation – You use it for gambling
 - On the supplier side who can hedge in the futures market? 

Swaps

Official Birth '1981'

- An agreement between two firms
- In which each firm agrees to exchange
- the Interest Rate Characteristics
- of two different financial instruments of identical principal
- Rarely done direct, banks are middlemen, bank profit is part of the swap 'gain' 

Basics

Why do firms invest abroad?

- Sell products in foreign markets to earn excess returns (Coke, Pepsi, GSK, Sun Pharma)
- Produce products more efficiently than domestically (Videocon International, Nokia)
- Secure necessary raw materials (Tata Tea, IFFCO, Posco)
- Miscellaneous (Pepsi Foods)

Exchange Rate Terms

- Exchange Rate - Amount of one currency needed to purchase one unit of another
- Spot exchange rate (1 Dh = Rs. 13.30)
- Forward exchange rate (1 Dh = Rs. 13.45)
- Currency risk - Volatility of exchange rates
 - Translation exposure; and
 - Transactions exposure

Forex Markets

- Forward Prices
- Spot price is 44.93 Rupees per dollar and 3 month forward rate is 45.56 Rupees per dollar
- USD has a higher value in the forward market than in the spot market.

Foreign Exchange Markets and Exchange Rates

- Without a doubt, the foreign exchange market is the world's largest financial market.
- Most currency is quoted in terms of dollars.
- Participants would include ...
- Most of the trading takes place in a few currencies:
 - U.S. dollar (\$); Euro (€); British pound sterling (£); Japanese yen (¥); 

Indian companies raising finance abroad

- American Depository Receipts (ADRs):
 - ... Also known as ADS.
 - A security issued in the U.S. to represent shares of a foreign stock (Infosys Technologies, Silverline Technologies, Wipro, WNS Global)
 - ... NYSE or NASDAQ
- Global Depository Receipts (GDRs):
 - Offering of Securities outside India and the US (Hindalco)
 - ... Usually Luxemborg Stock Exchange or London Stock Exchange 

Cash Management

- What should a firm do if it knew that a local foreign currency was going to fall in value?
- Exchange cash for real assets (inventories) whose value is in their use rather than tied to a local currency
- Reduce or avoid any increase in trade credit
- Obtain trade credit or borrow in the local currency