Tender Offer for Bonds:
A Case Study of Microsoft Corporation

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If you own a corporate bond, you may at some point be offered the possibility to exchange your bonds for a possible cash payment and possible replacement of your bonds with other securities. Not all tender offers are alike. They may offer an upfront cash payment for an early committal, a payment in cash, and/or a replacement bond. A tender offer is voluntary, meaning that you have a choice if you would like to participate.

The company, in this case Microsoft, offered to purchase bonds that you might own, in exchange for a cash offer, if you sign up quickly. In addition, you would receive new, longer maturity bonds that would be priced at a premium to a specified Treasury bond.

The new bonds would have a maturity 15 years longer than your current holding. In our example, the bonds you own mature in 2035 and you would be exchanging them for bonds maturing in 2050, a plus 15-year maturity extension. The new bonds would be based upon "a fixed spread of 75 basis points plus the yield based upon the bid side price of U.S. Treasury bonds 2.375% Notes due 11/15/2049, as quoted on page FIT1 on the Bloomberg reference bond trader series of pages at 10:00 AM New York City time on 5/14/2020." In addition, you would be offered $30 per bond in cash if you were to sign up before the cutoff date, which was May 12th 2020 - two days before the price set. Otherwise you get no cash bonus.

We reviewed the tender offer letter. It serves as a basis for evaluating other tender offers, though they are not all alike. They are always in the company's interest. You have to decide if the offer is in your interest.

We have the following comments:

The letter appears to be written by lawyers who must know that anyone who is not a professional bond trader could not make the required calculation. The cash bonus is meant to attract you, but you won't know what you would get until you have committed and cannot back out.

This letter is written for institutional bond investors, not retail or general financial advisors. The letter says that the relevant price is to be found:

on page FIT1 on the Bloomberg reference bond trader series of pages at 10:00 am New York City time, on 5/14/2020.

Even if you have a Bloomberg Terminal, there is not enough information with current numbers to make the calculation today. You must wait until 5/14/20. If you wait until that date, you miss the cash bonus. Only professional institutional bond traders have a Bloomberg Terminal.

Other missing information is what the coupon would be on the new bond. If you owned the bonds in question, you would be giving up a 4.05% coupon. Also, what would the new terms or call provisions be on the new bonds? On the bonds you own, there is a make whole call. Should we assume that the terms are the same as the current bonds? We are not provided with the 100-page indenture written by lawyers to review. No offering statement is required for a bond tender.

The carrot here is a small current cash payment. It is explained in the following manner. "The "Cash component" means the portion of the Total Exchange Consideration to be paid to holders in cash and is equal to (1) the applicable Cash Payment Percent of Premium for such series of Existing Notes multiplied by (ii) (a) the applicable Total Exchange consideration for such series of Existing Notes minus (b) $1,000." Then by way of explanation they state the following: "The cash payment percent of premium is 100% of the amount by which the total exchange consideration exceeds $1,000 per $1,000 principal amount of such Notes." If your eyes haven't glazed over yet, read it a few more times. Your understanding will not improve.

The possible downside of not taking this offer is that there is a make whole call* that the issuer can initiate at any time, and that may be on worse terms than the present offer. We discount this reasoning. If the make whole call were attractive to the issuer, they would have called the bonds instead of making the offer they did.

If you were to accept this offer, the term of the bonds extends the maturity by 15 years to 6/1/50. You would then own a thirty-year bond. That adds another uncertainty and increases your risk, while minimizes Microsoft's.

We have been given no information about the nature of investor protections in the new bonds. We don't know the coupon. We don't know the call protection. We don't know where the bonds stand in the hierarchy of debt. In short, we don't know anything.

Be advised: All tender offers are made to benefit the issuer, not the holder.

If you don't want to tender your bonds, you do nothing.

*If you want to know more about make whole calls, read our book: BONDS: The Unbeaten Path to Secure Investment Growth. 2nd edition. Bloomberg Press. An imprint of John Wiley. p.233.