



## **Convertible Bonds in a Rising Interest Rate Environment**

*21<sup>st</sup> June 2022*

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STIFEL

- ▶ **01** Introduction
- 02** Convertible Bond Market Conditions & Rising Interest Rates
- 03** Convertible Bonds from an Issuer's Perspective

# STIFEL

## Industry-focused, full service, global investment banking

- Full-service investment banking product portfolio, including M&A, public and private capital raising, institutional sales and trading and asset management
- Research-driven, industry-focused

## Mid-market and growth industry focus

- Commitment to small/mid cap companies
- Financing and M&A solutions across the entire corporate life-cycle from venture to public markets
- Partner to the transatlantic Private Equity and Venture Capital ecosystems

## Global access with local execution

- U.S. headquartered, European network, Asian and South American access
- Access to international and local capital
- Cross-border execution

(1) As of 31/12/2021

(2) As of 26/01/2022

## A transatlantic investment banking powerhouse for mid-market companies

### PLATFORM

- \$4.74bn revenues in 2021<sup>(1)</sup>, \$7.4bn market capitalization (NYSE)<sup>(2)</sup>
- Full-service investment bank focused on mid-market
- Over 2,000 stocks under research coverage globally
- Wealth management platform: \$305Bn in combined client assets under management across the U.S.

### HISTORY

- Founded in 1890 and publicly listed since 1983
- 18 investment banking acquisitions since 2005, including Miller Buckfire & Co., KBW, Inc. and Eaton Partners. In Europe, acquisitions of Oriel and MainFirst
- Focus on growth: 20% revenue CAGR since 2005

### PROFESSIONALS

- Over 8,000 professionals in approximately 400 locations
- Over 400 investment banking professionals

### INDUSTRY TEAMS

- |                                       |                   |
|---------------------------------------|-------------------|
| ▪ Technology                          | ▪ Healthcare      |
| ▪ Media & Telecom                     | ▪ Energy & Power  |
| ▪ Consumer & Retail                   | ▪ Transportation  |
| ▪ Diversified Industrials             | ▪ Real Estate     |
| ▪ Business Services                   | ▪ Materials       |
| ▪ Aerospace, Defence & Gov't Services | ▪ Food & Beverage |

### PRODUCT EXPERTISE

- |   |                           |
|---|---------------------------|
| ▪ M&A Advisory  | ▪ Restructuring Advisory  |
| ▪ Equity & Convertible Capital Raising (Public & Private) | ▪ Institutional Brokerage |
| ▪ Debt Capital Raising (Public & Private)                 | ▪ Private Client Services |
| ▪ Direct Lending (Stifel Bank)                            | ▪ Asset Management        |

## Primary Equity-Linked Capabilities

- Dedicated specialists advising, structuring and executing Convertible & Exchangeable Bonds for corporate issuers
- Specific focus on structuring new issues and restructurings for middle-market issuers
  - Bilateral convertible bonds: Up to €75m
  - Institutional convertible bond placements: €75 - €400m
- Expertise across entire equity-linked product suite
  - Primary Issues: Convertible & Exchangeable Bonds, Hybrids, Mandatories, Pre-IPO Convertible Bonds
  - Liability Management: Buybacks, Tender Offers, Exchange Offers, Consent Solicitations

## Dominant Equity-Linked Distribution Franchise

- One of the most experienced CB distribution teams in Europe and the US with 20+ years of average experience
- Dedicated CB sales and trading team with specific focus on mid-market issuers with evolving credit and equity stories
- Consistent and strong knowledge of investor universe – providing connectivity between issuer and investors
  - Access to over 300 investors with convertible bond mandates
- High trading market share (30%+ estimated) in convertible bond issues that Stifel focuses on
- Strong relationships with a number of specialist investors who are able to deploy capital into bespoke, bilateral CB deals

## Dedicated Team of Equity-Linked Specialists in Europe and the US

### Today's Presenters



**Michael Coakley**  
Head of Convertible Bonds  
Managing Director

- 30+ years in trading, distributing and restructuring convertible bond issues in Europe and Asia
- Credit Suisse, Merrill Lynch, DLJ, Lehman Brothers and ISM Capital



**Dhiren Suares**  
Head of Convertible Bond  
Origination (EMEA)  
Director

- 15+ years in investment banking focused on convertible bonds, debt capital markets and equity derivatives in Europe
- Lehman Brothers and Nomura

### North America

5 Managing Directors / Directors



### Europe

4 Managing Directors / Directors



Principal Convertible Bond Offices

# Overview of Convertible Bonds

## ➤ What is a Convertible Bond?

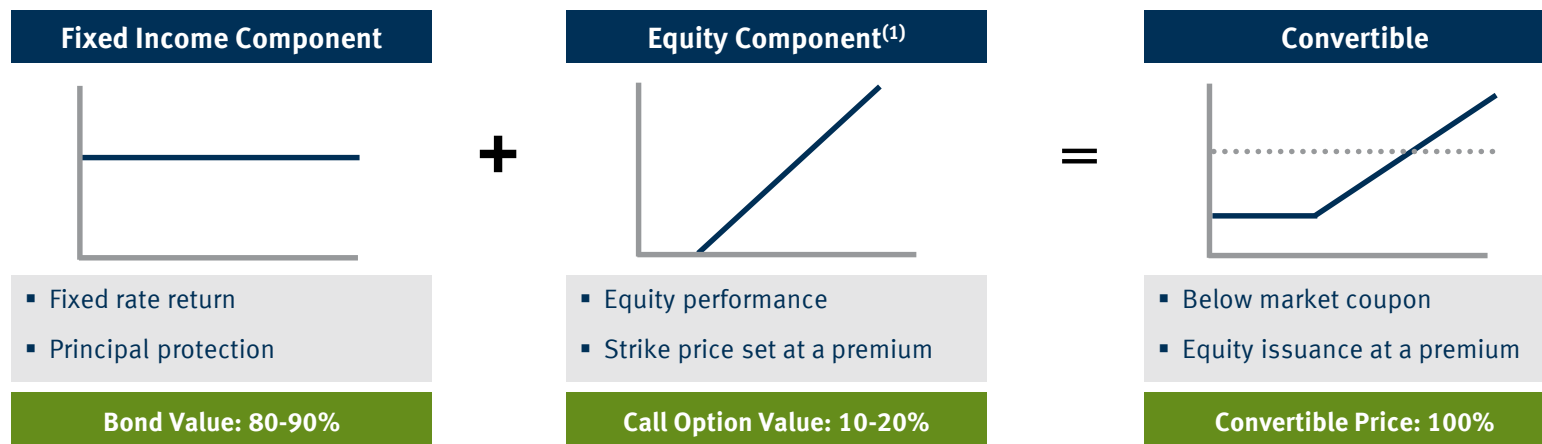
- **Convertibles are hybrid securities containing elements of debt and equity. They give the holder the right (but not the obligation) to convert the bond into a fixed number of new or existing (Treasury shares) ordinary shares:**

- The fixed income component provides a cash coupon and downside protection similar to a fixed income instrument
- The equity component provides upside potential, which reduces the coupon level payable relative to a regular bond

- **At maturity or if an issuer calls the bond**

- If the stock price is higher than conversion price, investors will convert
- If the stock price is lower than the conversion price, investors will not convert and redeem the bond at its principal amount

## Constructing a Typical Convertible Bond Payoff



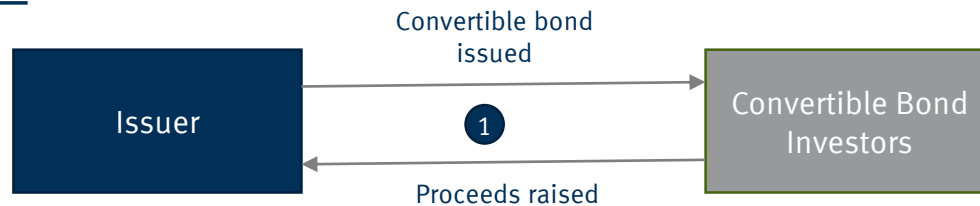
$$\text{Bond Value} + \text{Call Option Value} = \text{Convertible Price}$$

1. The equity component consists of a call option – i.e. the right (but not the obligation) for the convertible holder to require the company to repay, through the issue of new shares at a given 'strike' price

## Overview of Convertible Bonds (Contd.)

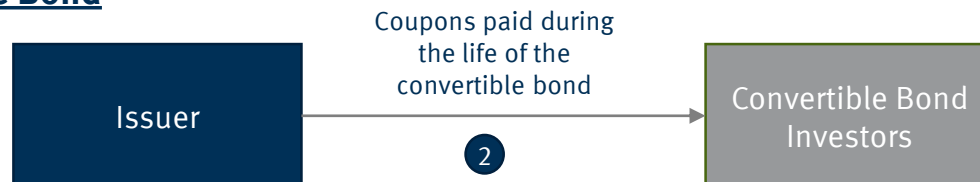
➤ Outlined below are the flows of a typical convertible bond, at issue, during the life of the bonds and at conversion or maturity

### At Issue



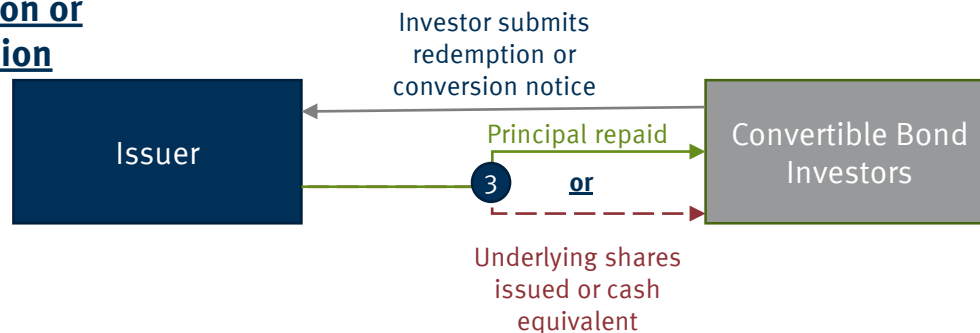
- **At issue:** Company issues a convertible bond and receives proceeds represented by the nominal value of the bonds

### During life of Convertible Bond



- **During the life of the convertible bond:** Issuer makes regular cash coupon payments to bondholders

### At Maturity - Redemption or Conversion



- **At maturity - redemption or conversion:**
  - **Redemption:** If the share price < conversion price => principal repayment
  - **Conversion:** If the share price > conversion price => underlying shares issued or cash equivalent of the underlying shares paid to bondholders

**01** Introduction

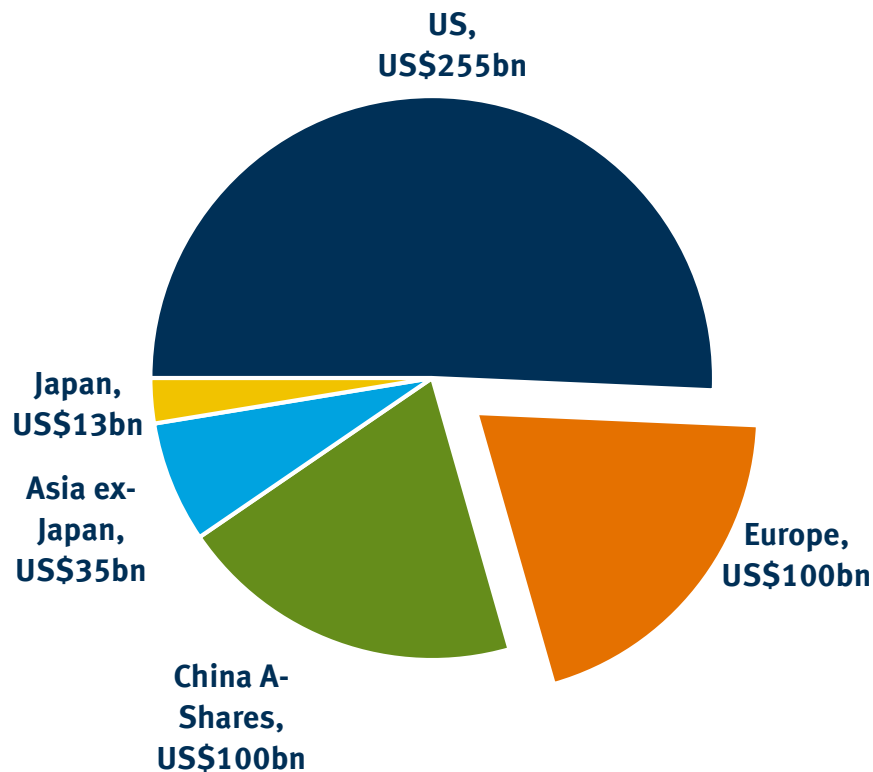
▶ **02** Convertible Bond Market Conditions & Rising Interest Rates

**03** Convertible Bonds from an Issuer's Perspective

# The Global Convertible Bond is c.US\$500m in Size

➤ The global convertible bond market is a distinct financing market with a dedicated investor base with its own benchmark indices

## Global Convertible Bond Universe (Outstanding Nominal Value)<sup>(1)</sup>



## Refinitiv Convertible Bond Index<sup>(2)</sup>

UCBINDEWX1414 Quote			
Global Focus			
EUR			
<UCBI>			
Refinitiv Convertible Indices			
Constituents <O#UCBGROUPW114>			
Index Details			
Values at Close 15JUN22			
Characteristics		Performance	
Currency	EUR	Index Premium	42.1
Hedged	No	Avg Running Yld	0.73
Mandatories	Exc	Avg Yield to Put/Mat	0.97
No. Issues	234	Avg Life to Mat (Yrs)	4.13
Mkt Cap	EURd 137	Avg Delta	44.3
		Index Volatility	
		1 Yr Daily Vol	8.5
		5 Yr Monthly Vol	8.3
		Implied Volatility	
		Avg Implied Vol	35.8
Comparative Performance			
		Convertible Value	Equity Parity Value
		% Move	% Move
		Cash Equity Value	% Move
Last Close	15JUN22	286.78	112.96
Start of Month	31MAY22	292.48	-1.95
Start of QTR	31MAR22	309.50	-7.34
Start of Year	31DEC21	327.07	-12.32
Year on Year	15JUN21	323.60	-11.38
		Cur	Unhedged
		PercentageChange	FX Hedged
		Index	Equity
Equalised at	31MAR22	-7.34	-17.30
Start of QTR	31DEC21	-12.32	-25.54
Start of Year	15JUN21	-11.38	-29.54
		Related Indices	
EUR	UCBINDEWX1414	UCBINDEWX1059	
USD	UCBINDEWX0204	UCBINDEWX1058	
CHF	UCBINDEWX1148	UCBINDEWX1068	
JPY	UCBINDEWX1147	UCBINDEWX1132	
GBP	UCBINDEWX1545	UCBINDEWX1303	



1. Source: Bloomberg.  
2. Source: Refinitiv.



# The Convertible Bond Market Has a Dedicated Investor Base

➤ The investor base mainly comprises two categories – (i) Long-Only Convertible Bond Funds and (ii) Convertible Bond Hedge Funds

## Types of Convertible Bond Investors

### ▪ “Long-Only” Convertible Bond Investors

- Focused on the underlying fundamentals of an issuer and macro outlook for the relevant sector
- Portfolios are based around the balanced return nature (i.e. upside participation with downside protection) of convertibles as an asset class

### ▪ Convertible Bond Hedge Funds

- Utilise equity hedging strategies to monetise the issuer’s share price volatility
- Operate market-neutral strategy by going long the convertible bond and short a portion of the underlying shares
- The short position is dynamically managed within the natural trading flows of the underlying equity
- Some convertible bond hedge funds take a partial long-only view based on their view of equity upside on the shares

### ▪ Crossover Investors

- Typically invest in debt or equity of an issuer; however, use convertible bonds to balance their return profile

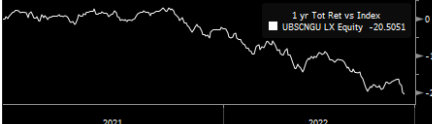
## Selected Convertible Bond Investors



## Dedicated Funds Manage Convertible Bond Exposure

- Funds have dedicated convertible bond mandates and hence do not cannibalise investor demand for straight debt or equity issues
- Some funds are marketed to HNWIs and retail investors offering equity-like returns with lower volatility

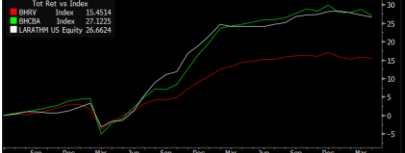
UBS (Lux) Bond SICAV - Convert Global EUR is an open-end investment fund incorporated in Luxembourg. The Fund's aim is capital appreciation. The Fund aims to participate in the growth of global stock markets while enjoying the added security provided by convertible securities. The Fund invests at least two-thirds of its net assets in convertible and option bonds worldwide. [FIGI BBG000QM7FS1]

Comparative Returns   COMP »			Bloomberg Classification	
			<b>Fund Type</b> SICAV <b>Asset Class</b> Fixed Income <b>Strategy</b> Convertible <b>Geo. Focus Region</b> Global	
NAV	EUR 15.740			
Assets	06/14/22	EUR 4.33B		
Performance	Return	Percentile	Fund Info	
1 Month	-2.54%	49	Inception Date	11/18/2004
YTD	-18.19%	21	Share Class	Retail
1 Year	-20.94%	17	Min Investment	N.A.
3 Year	1.71%	70	Min Subsequent	N.A.
5 Year	1.29%	70	Min IRA	N.A.
Px Source	F2C		Expense Ratio	1.88%
			Fees	
			Front Load	4.00%
			Back Load	.00%
			Early Withdrawal	N.A.
			Current Mgmt Fee	1.44%
			Performance Fee	.00%
			12b1 Fee	N.A.



LAZARD  
ASSET MANAGEMENT

Lazard Rathmore is a hedged convertibles strategy. In addition to generating returns from credit and volatility, the team's specialized approach focuses on extracting value from special situations and events, which supplements the traditional drivers of return to convertible arbitrage strategies.

Comparative Returns   COMP »			Bloomberg Classification	
			<b>Fund Type</b> Hedge Fund <b>Asset Group</b> Alternative <b>Strategy</b> Relative Value <b>Style</b> Convertible Bond Arbitrage <b>Geo. Focus Region</b> Global	
Performance	Return	Std Dev	Fund Info	
1 Month	-.46%		Fund AUM	USD 2.75B
YTD	-1.13%		Firm AUM	USD 220.86B
1 Year	2.02%	1.78%	Inception Date	06/01/2007
3 Year	8.73%	5.98%	Closed To New Investors	No
5 Year	6.93%	4.82%	Investor Type	FIGI
NAV	04/29/22	USD 3231.38	FIGI	BBG00KH6ZMS6
Px Source	Lazard Asset Manage...		Terms	
			Management Fee	N.A.
			Performance Fee	N.A.
			Notice Period	0 Days
			Redemption Freq	Unknown
			Hard Lock Period	0 Days
			Subscription Freq	Unknown
			Min Investment	N.A.

Source: Bloomberg.

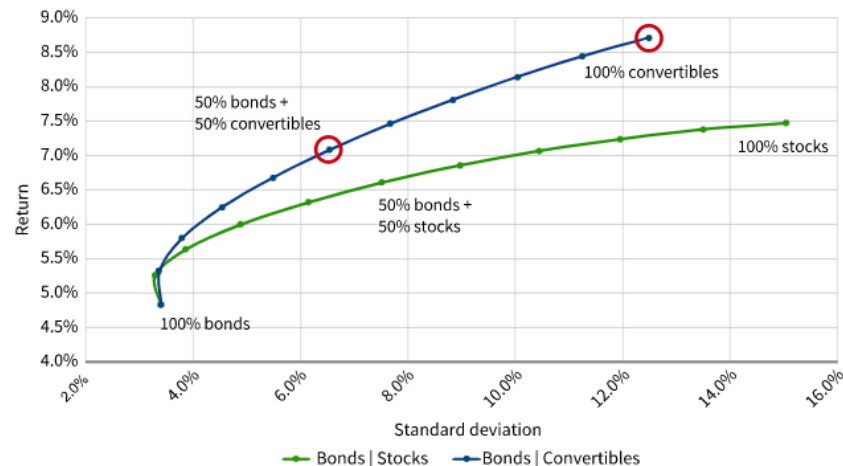
# Rising Interest Rates – Valuation Impact on Straight Bonds, Convertible Bonds and Equities from an Investors' Perspective

➤ *Convertible bonds offer a more balanced return profile during periods of significant and sudden movements in interest rates*

## Percentage Return of Straight Bonds, Convertible Bonds and Equities<sup>(1)</sup>

Time Period	Nov '01 – Apr '02	Jun '03 – Jun '04	Jun '05 – Jun '06	Dec '08 – Jun '09	Oct '10 – Feb '11	Jul '12 – Dec '13	Jul '16 – Dec '16	Sep '17 – Nov '18	Aug '20 – Mar '21
Yield Increase (bps) <sup>(2)</sup>	122	176	134	187	134	157	123	119	122
Bloomberg U.S. Govt/ Credit	-3.1	-3.6	-1.5	-2.1	-3.9	-2.1	-4.9	-3.3	-4.8
ICE BofA All U.S. Convertibles	2.3	11.5	9.5	24.7	11.6	35.5	7.6	9.1	28.4
S&P 500	3.1	14.7	6.7	9.4	14.9	42.1	8.7	16.4	21.5

## Illustration: How Convertibles Optimize Portfolios<sup>(3)</sup>



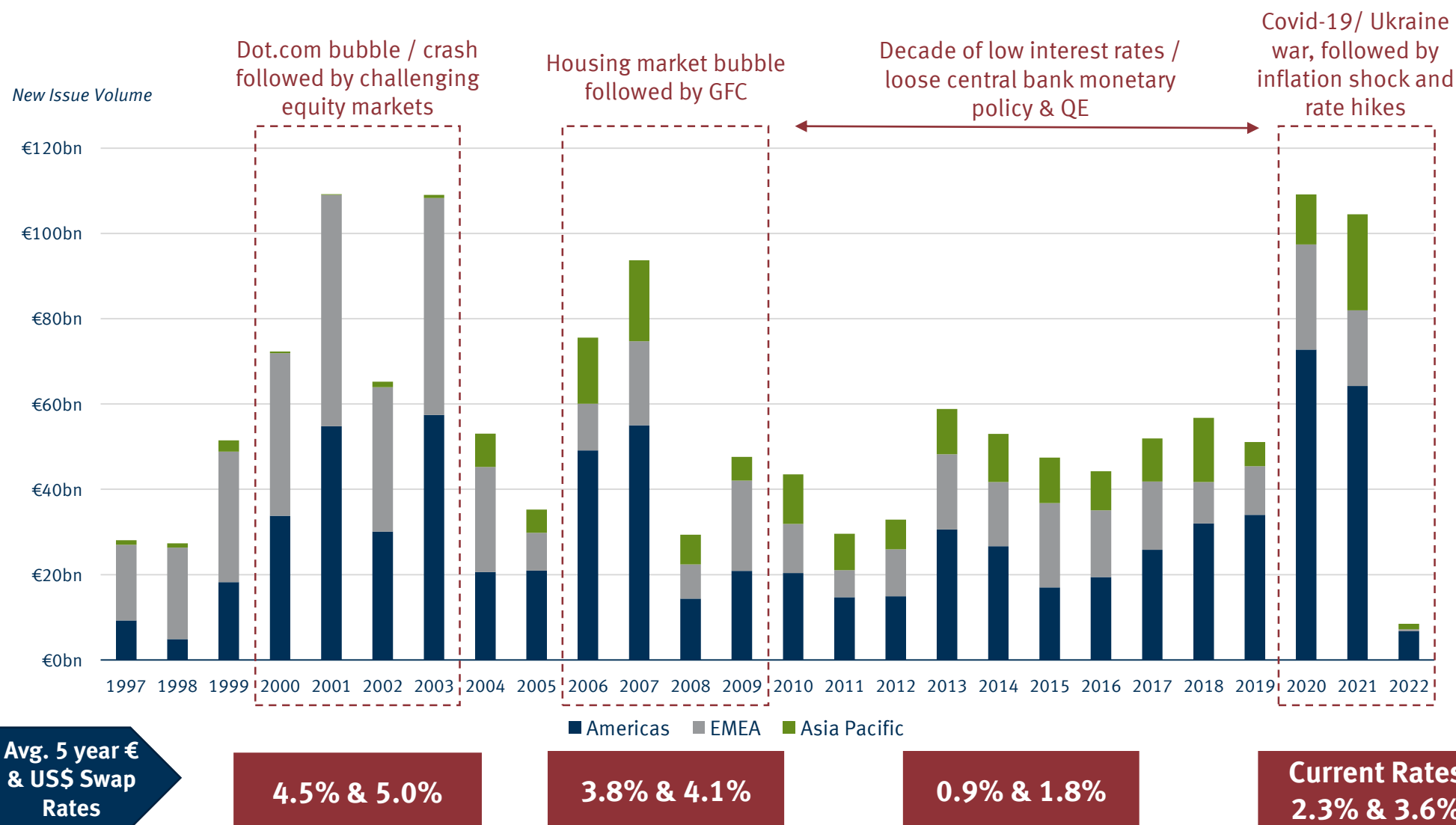
1. Source: <https://www.calamos.com/blogs/investment-ideas/more-on-convertibles-and-rising-interest-rates/>

2. 10-year Treasury Yield. Rising rate period is defined as from troughs to peak from November 2001 to March 2021.

3. Source: Putnam. Results are for 20 years ended 9/30/21. Portfolios are rebalanced quarterly. Bonds represent the Bloomberg U.S. Aggregate Bond Index; stocks represent the S&P 500 Index; convertibles represent the ICE BofA U.S. Convertible Index.

# Global Convertible Bond Issuance Since 1997

- The new issue market for convertible bonds is the largest in the US, followed by Europe and Asia
- Issuance volumes tend to increase during periods of elevated equity volatility or high interest rates

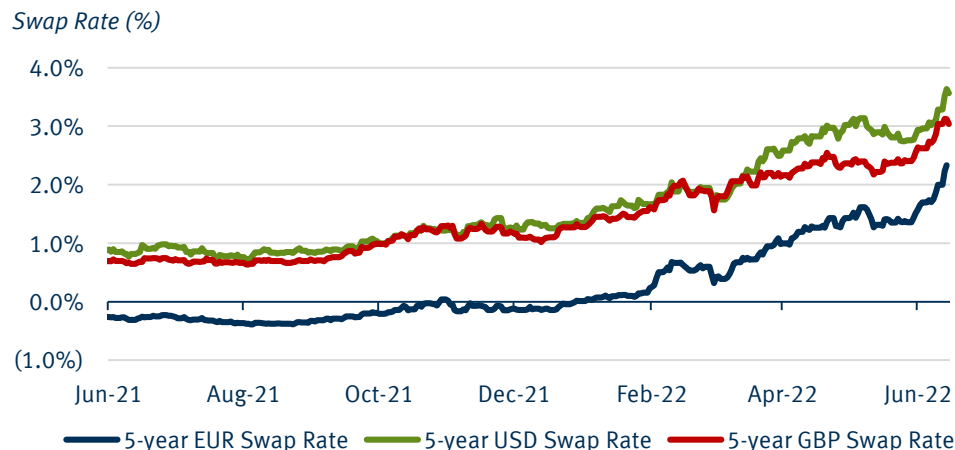


Source: Dealogic as of 14<sup>th</sup> June 2022. Excludes domestic issuance, mandatory securities and equity-linked issuance below US\$50m.

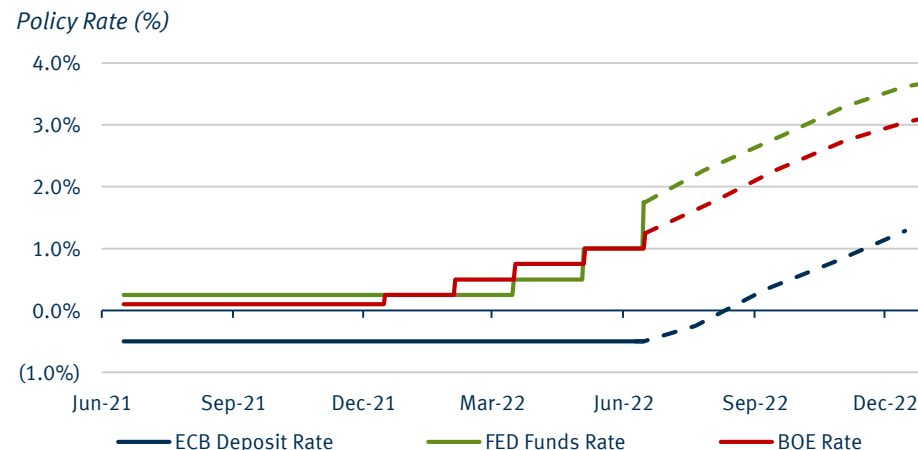
# Increase in Interest Rates and Equity Volatility

- *Central banks have begun to raise interest rates in response to persistently high inflation which is impacting all asset classes*
- *Higher interest rates & credit spreads are likely to make issuers consider convertible bonds as they offer low cash coupon debt financing*

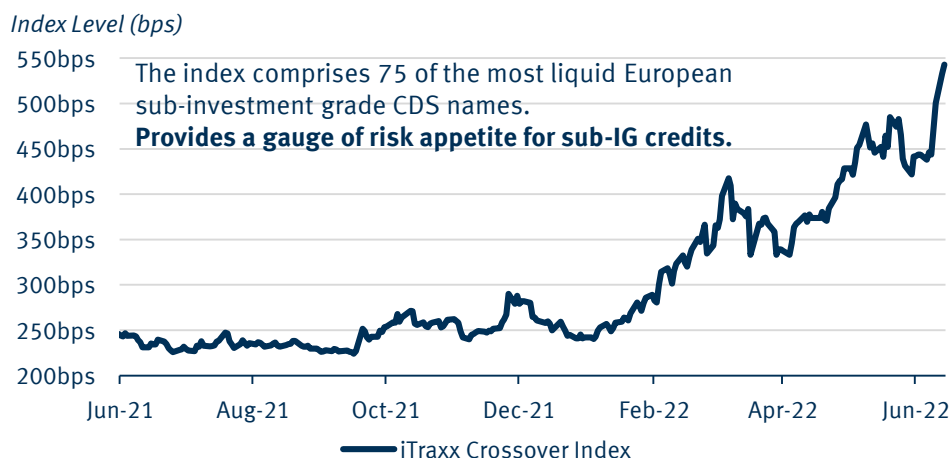
## Evolution of 5yr EUR, USD & GBP Swap Rates



## Implied Path of Central Bank Rates

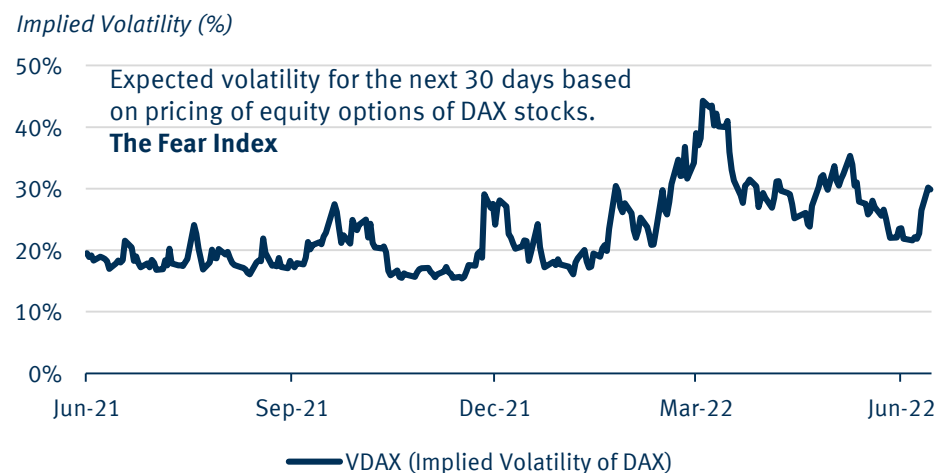


## iTraxx Europe Crossover CDS Index



Source: Dealogic and Bloomberg as of 14<sup>th</sup> June 2022.

## Deutsche Borse VDAX Volatility Index



**01** Introduction

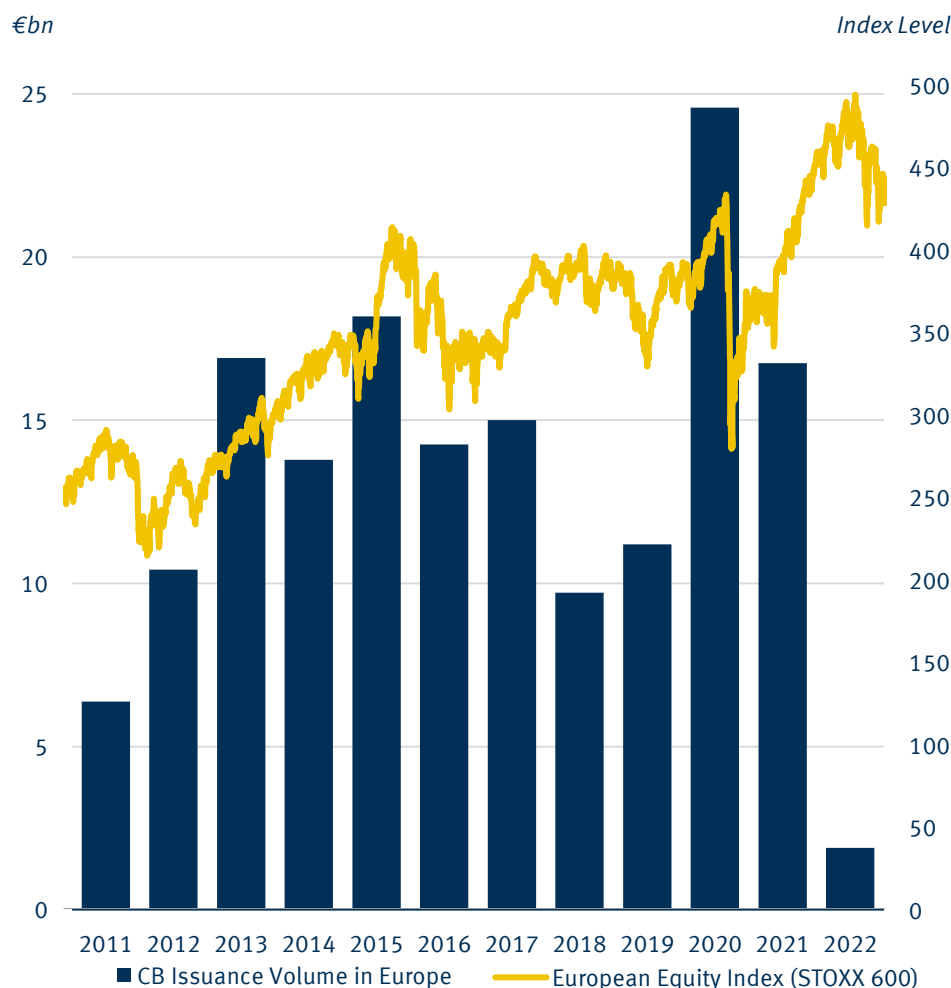
**02** Convertible Bond Market Conditions & Rising Interest Rates

**▶ 03** Convertible Bonds from an Issuer's Perspective

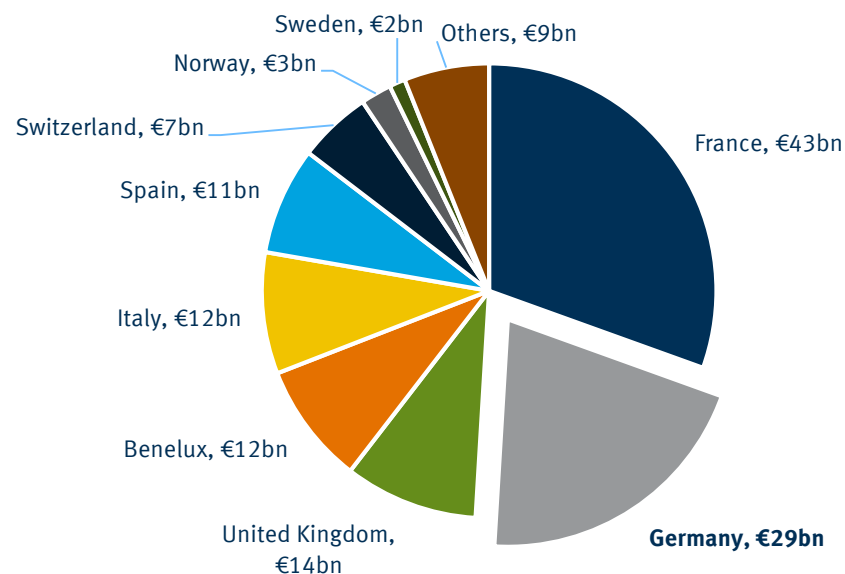
# European Convertible Bond Market Dominated by German and French Issuers

- European convertible bond issuance was strong in 2020 and 2021 with €25bn and €17bn issued respectively
- Lack of issuance in 2022 is creating pent-up demand as investors seek to deploy capital to the asset class
- German issuers represent over €29bn of issuance in the European convertible market since 2011

European Convertible Bond Issuance Volume Since 2011



Convertible Bond Issuance Volume Since 2011



Selected German Convertible Bond Issuers



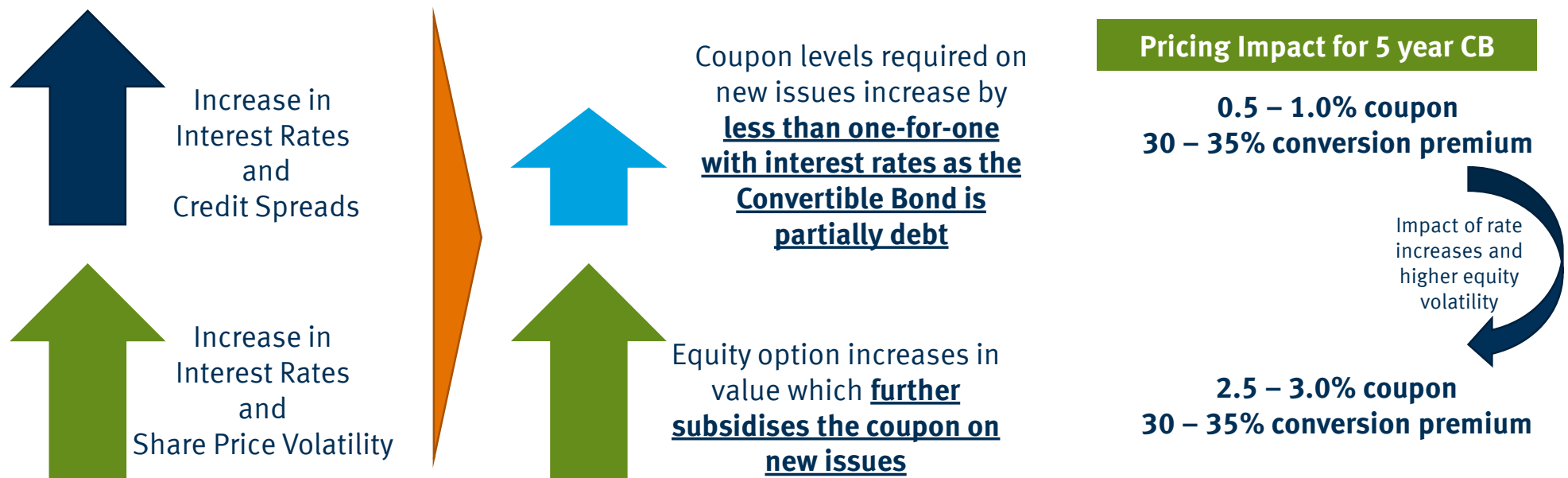
Source: Dealogic and Bloomberg as of 14<sup>th</sup> June 2022. Excludes mandatory securities and equity-linked issuance below US\$50m.

# Rising Interest Rates – Pricing Impact on Straight Bonds & Convertible Bonds from an Issuer's Perspective

## Straight Bond Pricing Dynamics



## Convertible Bond (CB) Pricing Dynamics



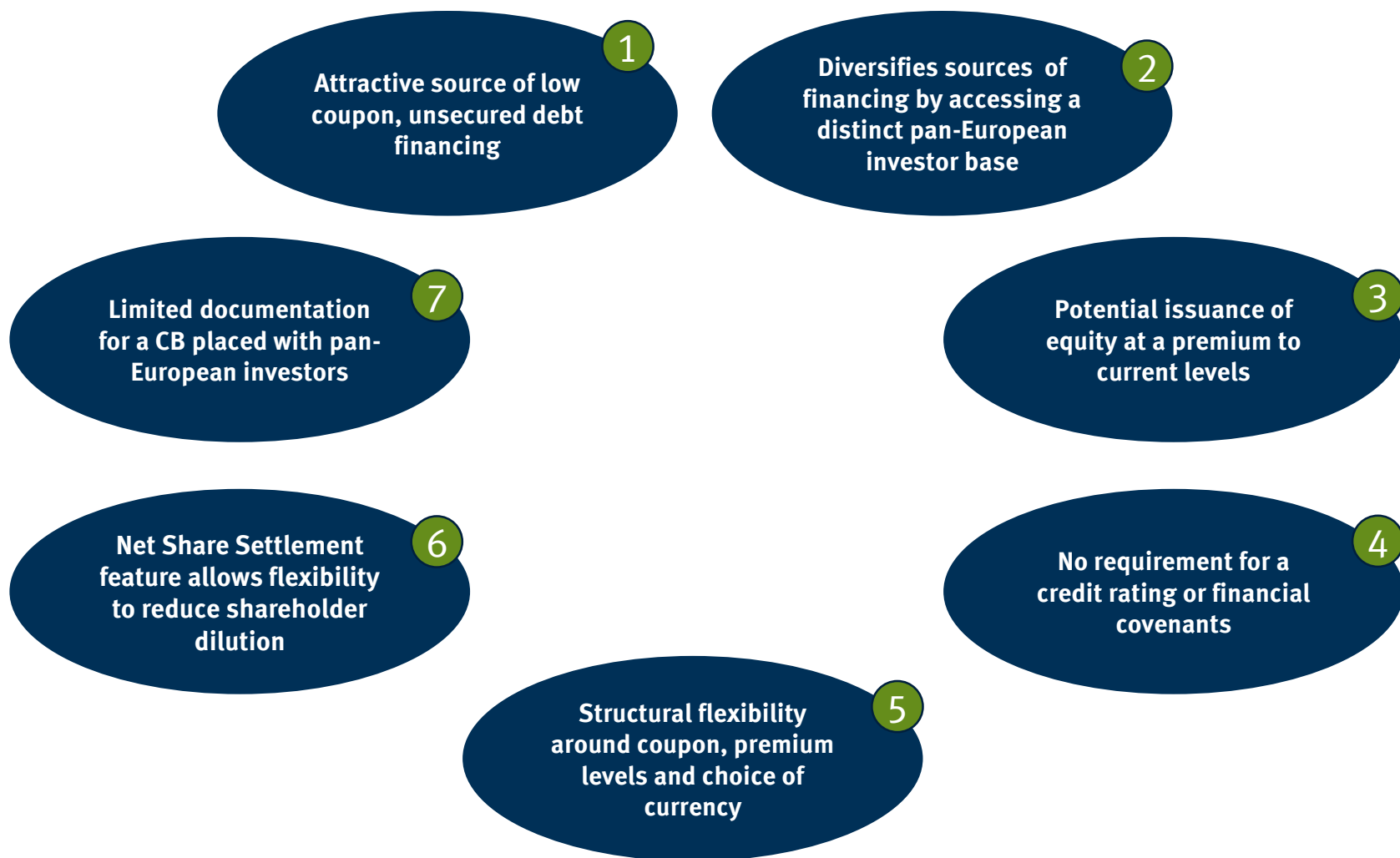
**Absolute share price levels need to be considered given potential dilution**



## Rationale for Considering Convertible Bond Financing

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- *Convertible bonds offer financing flexibility and diversifies an issuer's sources of financing*



# Potential Use of Proceeds for a Convertible Bond

- *A convertible bond could be used for a variety of reasons and creates capital structure flexibility*



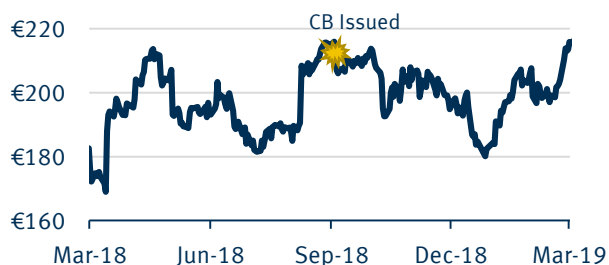
# Use Cases of Convertible Bonds in Mature, Challenging & Growth Situations

➤ Below precedents show diverse applications of convertible bond instruments in varying financing situations



Convertible Bond Key Terms	Issue Date	Sep-18
	Mkt Cap at Issue	€43.3bn
	Size	€520m
	Tenor	5 years
	Coupon	0.05%
	Premium	40%

## Adidas Share Price Performance



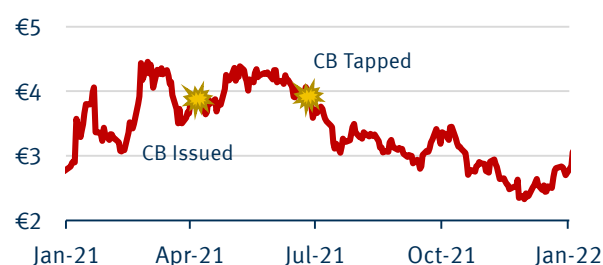
### Use of proceeds:

*"The issuer intends to use the net proceeds of the offering of the Bonds for general corporate purposes (including, without limitation, to finance a portion of the multi-year share buyback program)"*



Convertible Bond Key Terms	Issue Date	Jun-21
	Mkt Cap at Issue	€5.0bn
	Size	€590m
	Tenor	7 years
	Coupon	5%
	Premium	25%

## TUI Share Price Performance



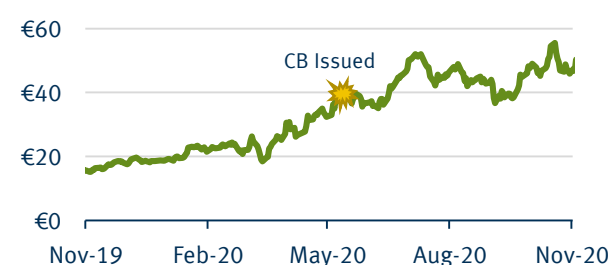
### Use of proceeds:

*"The issuer intends to use the proceeds from the Offering to further improve its liquidity position as the Covid-19 crisis continues and subsequently for the repayment of existing financing instruments"*



Convertible Bond Key Terms	Issue Date	May-20
	Mkt Cap at Issue	€6.0bn
	Size	€175m
	Tenor	5 years
	Coupon	0.75%
	Premium	40%

## Hello Fresh Share Price Performance



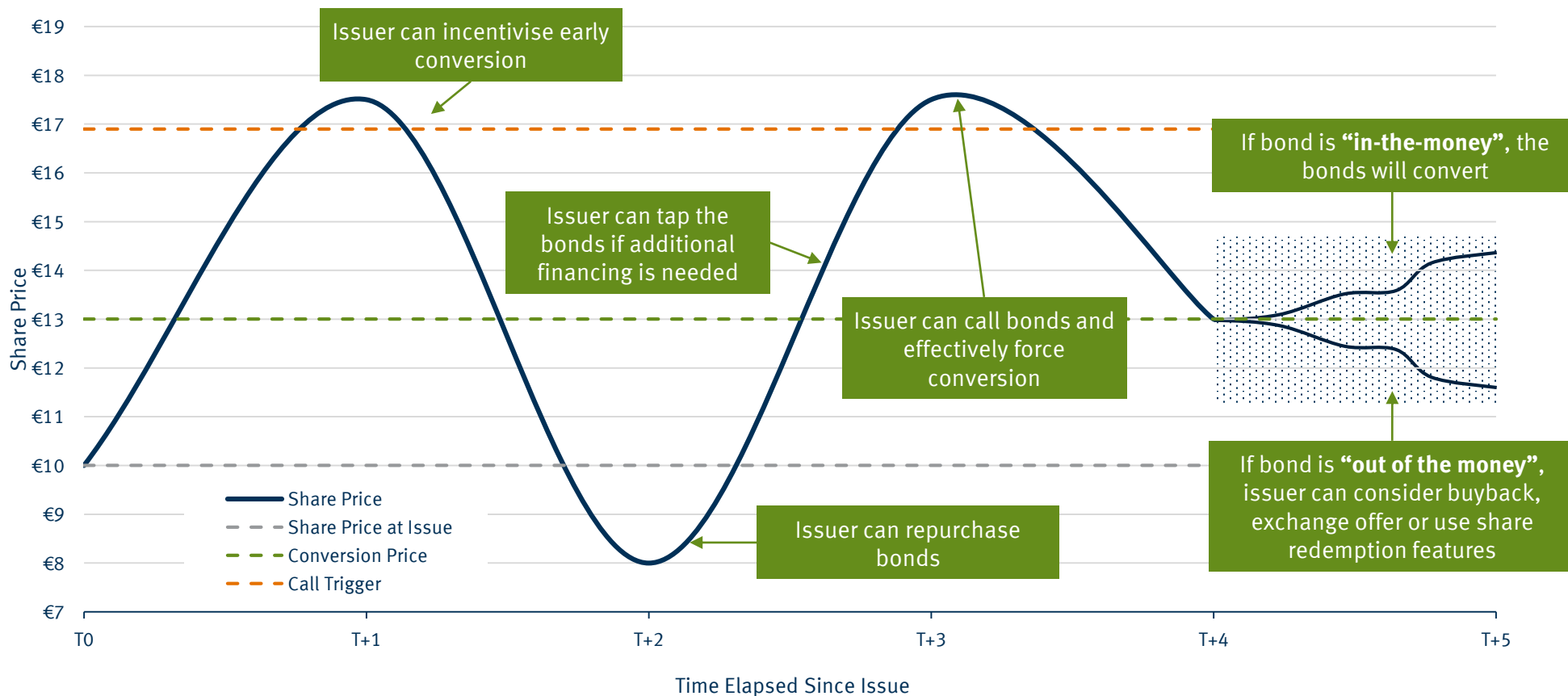
### Use of proceeds:

*"The proceeds from the issue of the Bonds will be used to support the Issuer's continued growth strategy, including further capacity expansion, and for general working capital purposes."*

Source: Dealogic as of 9<sup>th</sup> June 2022. Excludes CBs with issuance size below USD50m.

# Liability Management Options Through the Convertible Bond Lifecycle

➤ Issuers can manage the convertible bond liability in a variety of ways during the life of the instrument and at maturity

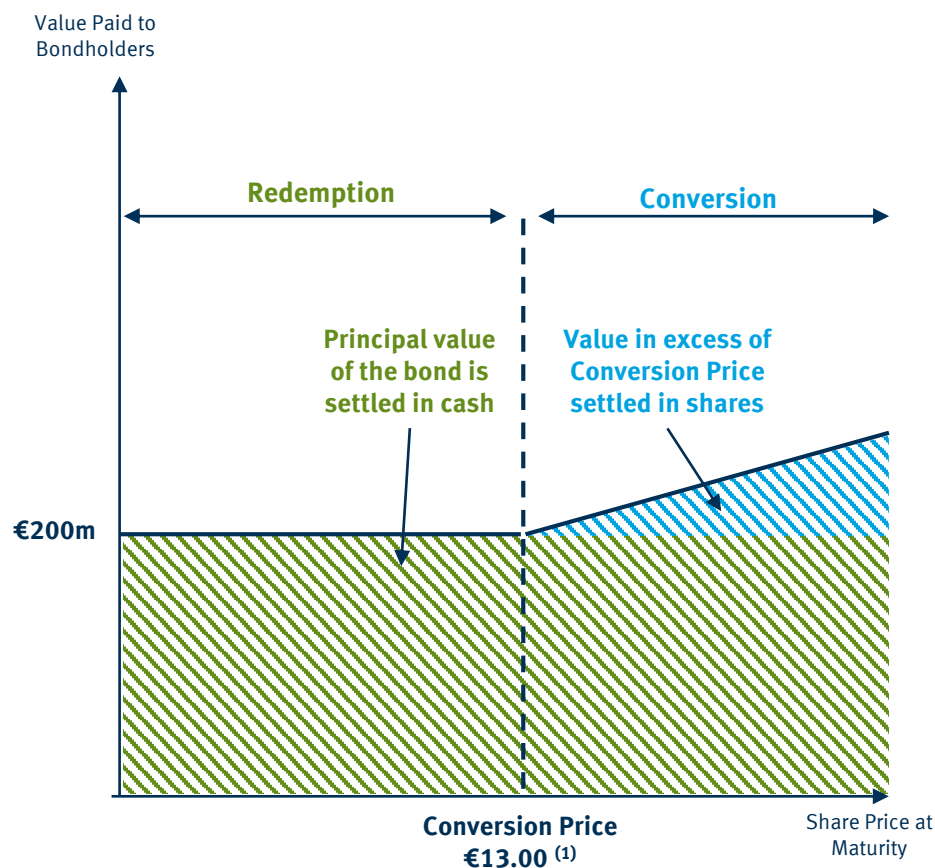


1. Assumes initial share price of €10, conversion premium of 30% and soft call trigger of 130% of the initial conversion price.

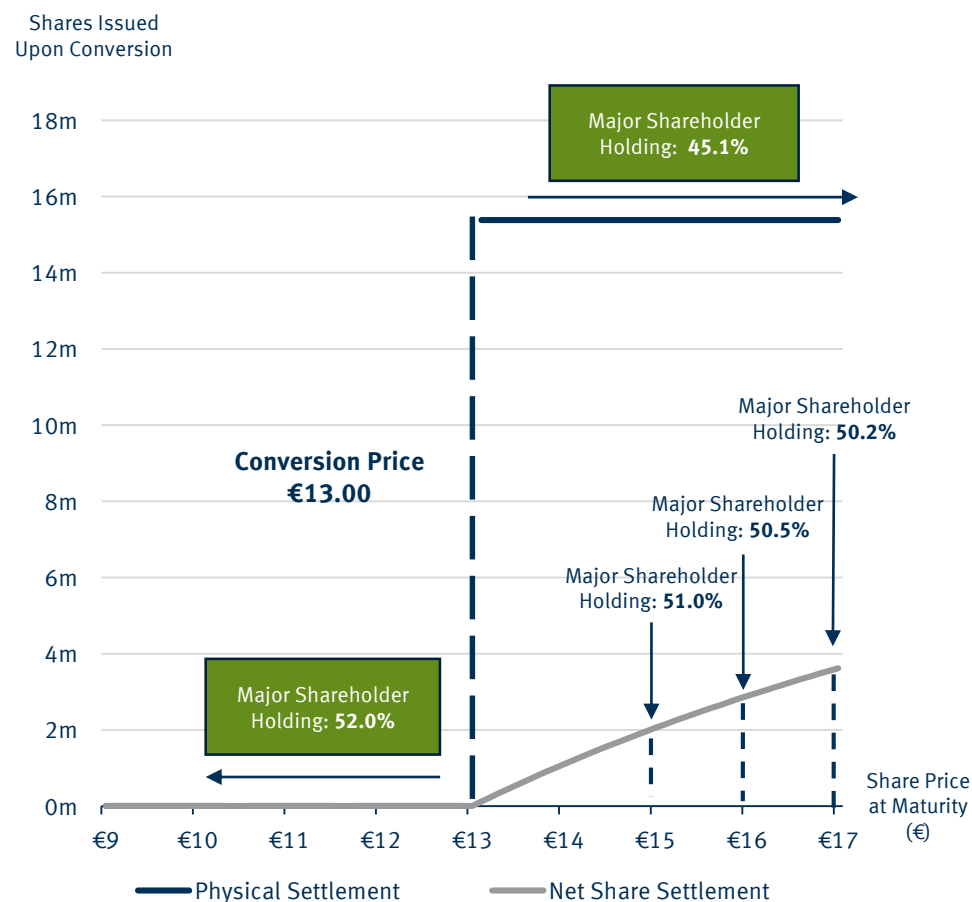
# Limiting Shareholder Dilution Using Cash or Net Share Settlement

- Issuers can include cash or net share settlement features in the bond which would limit shareholder dilution
- Cash Settlement allows issuers to settle any conversions by paying the cash equivalent value of the underlying shares
- Net Share Settlement allows issuers to repay the principal amount of the bond in cash and only the “in-the-money” portion of the bond in shares

## Value Paid to Bondholders at Maturity



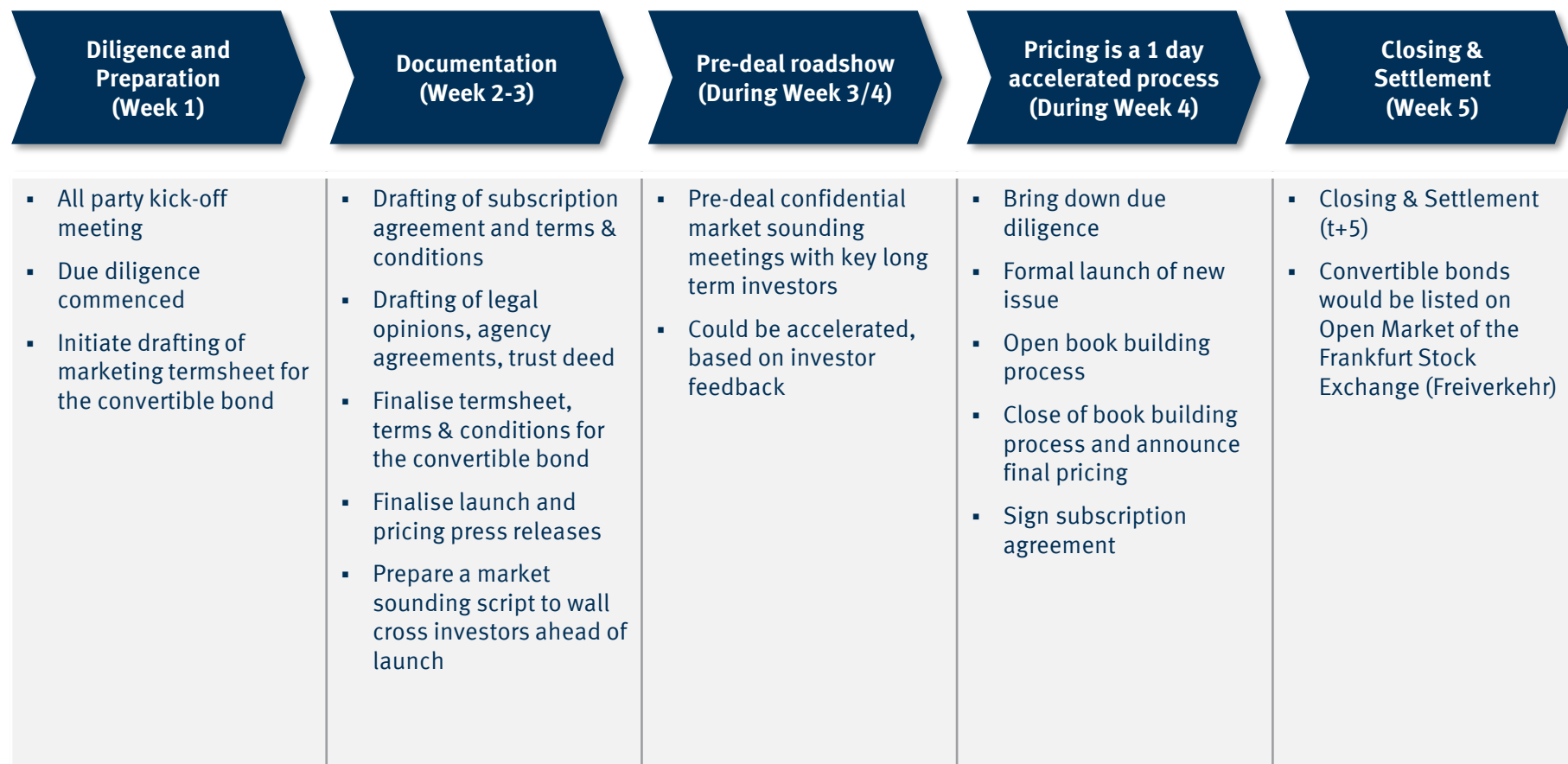
## Shares Issued In Physical vs. Net Share Settlement



(1) Based on initial share price of €10 on and a conversion premium of 30.0%. Assumes 100m shares outstanding at issue.

## Convertible Bonds Can be Executed Very Quickly

- *A convertible bond can be launched and priced within 4 weeks from kick-off*
- *A prospectus is not required for a convertible bond placed with institutional investors which limits the documentation process*



## Key Takeaways

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*Unwinding of QE and tightening of central bank monetary policy is impacting all financing asset classes*

*Significant increase in cost of capital for issuers across sectors and credit spectrum*

*Stifel expects strong new issue demand for convertible bonds in H2 2022 and 2023 as investors are keen to deploy their cash positions.  
Natural redemptions and conversion of outstanding convertible bonds need to be re-invested*

*The risk / reward profile of convertible bonds is likely to attract more fund flows to the asset class in volatile markets*

*Shareholder dilution could be managed by including cash or net share settlement options*

*Convertible Bonds are likely to be an efficient source of financing to limit interest costs and managing balance sheet liquidity in a high interest rate environment*

# Q&A



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