

**Questions 1 through 6 relate to Fixed Income.**

**Miranda Hamilton Case Scenario**

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Miranda Hamilton works as a fixed income analyst for an investment management firm. Recently, Hamilton was asked by her boss to analyze the financial statements of Bull Electronics (BEL), a company that specializes in manufacturing and selling electronic equipment. Hamilton has been going through the firm's financial statements. Some of the information provided by the firm's annual financial statements is given in Exhibit 1.

**Exhibit 1**

<b>Year ended December 31</b>	<b>2009 (in millions)</b>
Net Income	\$550
Depreciation	\$180
Amortization	\$50
Capital Expenditures	\$50
Increase in working capital	\$90
Interest	\$40
Total current Liabilities	\$3,330
Total long-term debt	\$2,120
Total current assets	\$4,440
Inventories	\$990
Common Equity	\$6,500
Cash Dividends	\$55
Principal repayment	\$112

Hamilton is also researching the credit worthiness of BEL and while doing so she came across the following information:

1. BEL has a back up credit facility provided by a large reputable bank. The facility provides funds to the firm when needed and contains a material adverse change clause.
2. BEL has a high degree of institutional ownership.
3. BEL has an operating subsidiary in Boston that has recently borrowed \$15 million from a bank. BEL has provided a financial guarantee to the bank on behalf of its subsidiary.

While researching the firm's financial statements, Hamilton found out that BEL has financed a good deal of their purchases with short term debt. However, BEL owns all of its long-term, fixed assets. Hamilton has asked Taylor Dunn, her colleague, for help in the credit analysis. During a discussion with her, Dunn made the following comments:

Statement 1: “Since BEL has been a credit worthy firm in the past, you should focus your analysis on the firm’s level of funds generated from operations and its relation to the firm’s total debt burden as this will provide a better credit assessment.”

Statement 2: “When analyzing the credit risk of the debt BEL has issued, the analysis of collateral will not be that useful because the absolute priority rule is generally followed in corporate reorganizations.”

Dunn is analyzing the credit risk of an asset-backed security. When discussing the differences between the credit analysis of asset-backed securities and corporate bonds, Dunn mentioned that the cash flow in an asset-backed security transaction is more predictable than the cash flows generated by a corporation. Hamilton mentioned that the credit analysis of an ABS transaction that is hybrid should be done using a ‘quasi-corporate approach’.

BEL has just borrowed \$5 million to finance the purchase of some machinery. The covenants contained in the bond indenture subject BEL to a maintenance test and a debt incurrence test.

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1. With regards to the information that Hamilton came across while analyzing the credit worthiness of BEL, which of the following *most likely* supports a high credit rating for BEL?
    - A. 2 only
    - B. 1 and 2
    - C. 2 and 3
  
  2. Which one of the following capitalization ratios would provide the *most* appropriate estimate of BEL’s extent of financial leverage?
    - A. Long-term debt to capitalization ratio
    - B. Total debt to capitalization ratio
    - C. Total debt adjusted for operating leases to capitalization ratio
  
  3. Dun is *most likely* correct with respect to:
    - A. statement 1 only.
    - B. statement 2 only.
    - C. both statements 1 and 2.
  
  4. Are Dunn and Hamilton correct with respect to their comments about asset backed securities?
    - A. Only Hamilton is correct.
    - B. Only Dunn is correct.
    - C. Both are correct.

5. The tests BEL is subject to for the \$5 million loan are *most likely* examples of which type of covenants, and which one of the two tests is more stringent?

<b>Type of Covenants</b>	<b>More Stringent Test</b>
A. Negative	Maintenance test
B. Positive	Debt Incurrence test
C. Negative	Debt Incurrence test

6. Based on the information given in Exhibit 1, the firm's debt service coverage ratio and debt payment period for the year 2009 are *closest* to:

- A. 5.580 and 5.692, respectively.
- B. 4.4737 and 9.316, respectively.
- C. 5.39 and 8.516, respectively.