

FORD MOTOR CREDIT COMPANY¹

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¹ This case is adapted from an earlier version of the Ford Motor Credit case published by IMEDE, Lausanne Switzerland.

Ford Motor Credit Company

(Medium-term US\$/SFr Transaction – MUST Bond)

In April 1987, the Ford Motor Credit Company of Dearborn, Michigan issued a prospectus (see Exhibit 1) for its first MUST bond on the Swiss bond Market. The new bond was issued by a consortium of banks led by Union Bank of Switzerland (UBS). The MUST bond was a hybrid security that combined cash flows in both US\$ and Swiss francs for periodic interest payments and principal repayments. (see Exhibit 2)

After issuing the bond, it was expected that Ford Motor Credit would swap the Swiss franc portion of the bond for US dollars, leaving Ford with a 15-year bond with payments of interest and principal in US\$ only.

Because this type of bond was new on the Swiss market, Mr. Hansjoerg Sommerau, Manager of UBS's new financial instruments group was asked to review the bond from the perspective of the Bank's institutional investors. UBS needed to determine a method for valuing the MUST bond before deciding whether or not to recommend the bond to its clients.

Surely, Mr. Sommerau thought, he needed to come up with some exchange forecasts because some of the bond's future cash flows were in a foreign currency. But some of Mr. Sommerau's colleagues disagreed.

As a first step, Mr. Sommerau decided to compare the Ford MUST bond to other opportunities in the US\$ and Swiss franc bond market. The Swiss franc portion of the bond offered interest of 5.5%, or 1% above prevailing rates for equivalent 7-year Swiss franc bonds. The US\$ portion of the bond was somewhat similar to a 15-year US\$ bond with coupon payments in the final eight years but effectively a zero coupon instrument over the first seven years. This US\$ bond was priced to yield 8.0%.

Answer the questions that are presented below. In your calculations, assume that the Swiss franc/\$ exchange rate is 1.50 SFr/\$ on the bond issue day.

QUESTIONS:

1.
 - a. Describe the technique or approach that you would use to value this bond.
 - b. What monetary value would you place on the bond on the day of issue (May 14, 1987)?
2.
 - a. Is this bond a "good deal" for Ford Motor Credit Corporation? Explain why or why not.
 - b. Is this bond a "good deal" for the investor? Explain why or why not.
3.
 - a. What type of investor would be interested in the Ford MUST bond?
 - b. What are the risks and benefits to the investor who buys the bond?
 - c. What expectations would the investor have who decides to buy this bond?
4. The spot exchange rates on the anniversary dates of the bond were roughly as follows:

May 14, 1988	1.445 SFr/\$
May 14, 1989	1.714 SFr/\$
May 14, 1990	1.431 SFr/\$
May 14, 1991	1.485 SFr/\$
May 14, 1992	1.456 SFr/\$
May 14, 1993	1.418 SFr/\$
May 14, 1994	1.403 SFr/\$
May 14, 1995	1.167 SFr/\$
May 14, 1996	1.254 SFr/\$
May 14, 1997	1.440 SFr/\$
May 14, 1998	1.484 SFr/\$

In general, did these exchange rates serve to make the realized return on the Ford MUST bond higher or lower than they initially expected (for Swiss investors)? Explain why or why not.

EXHIBIT 1

Ford Motor Credit Company – MUST Bond, Prospectus

Prospectus dated April 28, 1987



FORD MOTOR CREDIT COMPANY

Dearborn, Michigan, U.S.A..

MUST-Bond
(Medium-term US\$/SFr.-Transaction)

SFr. 150,000,000
5 ½% / 7 ½% SFr./US\$ Bonds 1987-2002
due May 14, 1994 and 2002

Issue Price: 100% (plus 0.3% tax on negotiation of securities)
Life: 15 years
Interest Rates: 5 ½% p.a. payable in SFr. Until May 14, 1994 and thereafter 7 ½% p.a.
payable in US\$
Redemption: 40% in SFr. on May 14, 1994
60% in US\$ on May 14, 2002
Settlement Date: May 14, 1987
Delivery of the Bonds: Not prior to August 14, 1987

Selling Restriction: USA (see following page)

The Banks named below have agreed to purchase these Bonds and offer them for public subscription until April 30, 1987, Noon.

Schweizerische Bankgesellschaft
Union de Banques Suisses

Goldman Sachs Finanz AG

Bank Leu AG
Banque Leu SA

Schweizerische Kantonalbanken
Banque Cantoniaires Suisses

Banca della Svizzers Italiana

Bank Cantrade AG
Banque Cantrade SA

Banque Romande

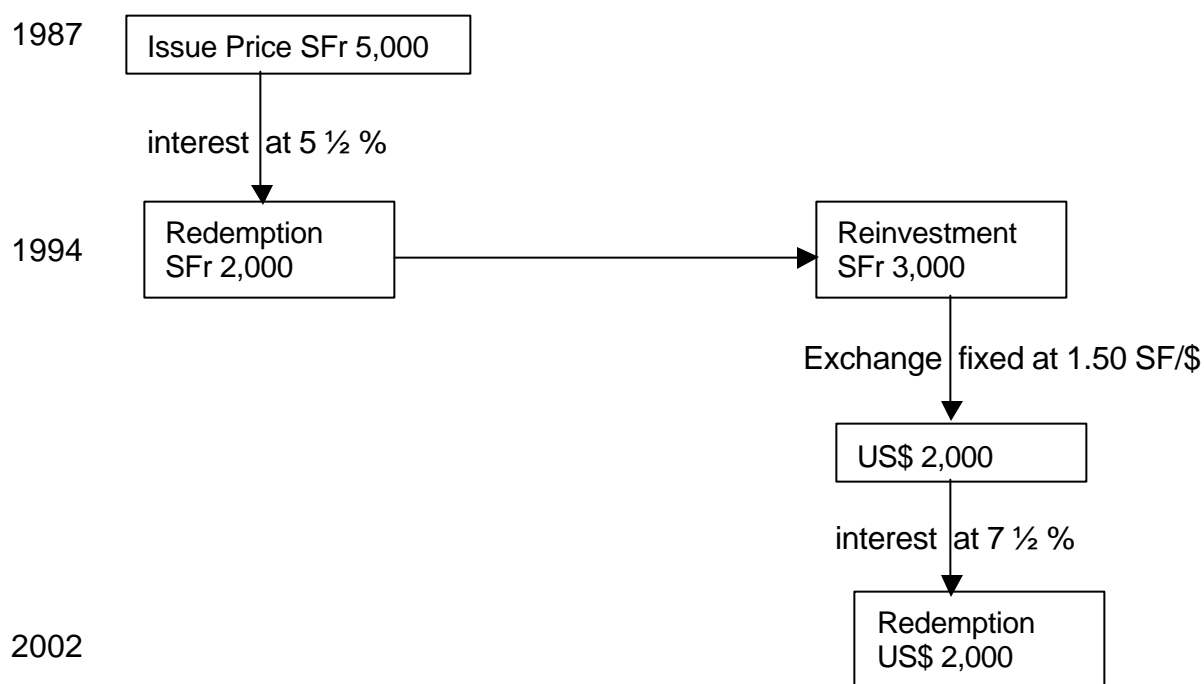
EXHIBIT 2

Ford Motor Credit Company – MUST Bond

Characteristics of a MUST Bond:

The MUST bond is a hybrid instrument, combining a Swiss franc straight bond with a US dollar straight bond. During the first period of time, the bond pays interest in Swiss francs on the nominal principal amount. Then, after seven years, a partial redemption of the bond in Swiss francs takes place. The remaining nominal principal amount is then converted into US\$ at an exchange rate fixed on the issue date (in this case, 1.50 SFr/US\$). After this date, the investor receives interest in US\$ on the nominal principal amount outstanding, until the final redemption of principal in US\$ at maturity.

Details of the Ford MUST Bond:



Reference interest rates and exchange rates prior to the offering date:

		<u>3-month Euro-\$</u>	<u>3-month Euro-Swiss franc</u>	<u>SFr/US\$ spot rate</u>
1987	March	6.63 %	3.625 %	1.538
	February	6.38	3.875	1.541
	January	6.13	3.625	1.560
1986	December	6.25	3.875	1.668
	November	6.00	3.875	1.688
	October	5.75	3.750	1.642