WHY HIGH YIELD DEBT ISSUERS CALL BONDS EARLY

December 2025

Insight Investment[1] looks at why it makes economic sense for high yield issuers to typically call their bonds early and the potential benefits for investors.

The structure of high yield bonds

Most high yield bonds have structures which allow the issuer to redeem the issue at set future dates before its final maturity. This is very different to the investment grade market where bonds generally have a single maturity date. These redeemable dates are known as call dates, and generally an issuer has to pay a price above 100 to redeem or 'call' the bond early. The bond's call terms – prices and dates – are fixed at issuance and documented legally, meaning they cannot be altered later. These terms remain unchanged regardless of market conditions or where the bond is trading. They are agreed between the issuer and the investor, and form part of the bond's contractual structure.

The earlier the call, the higher the price the issuer needs to pay, declining over time to 100 at final maturity. For example, a bond may mature in 2028 at 100, but be callable in 2026 at 101. Once markets expect a bond to be called, the price of the bond tends to gravitate towards the call price and the investor makes a gain in excess of market returns.

Six reasons companies call bonds early

Issuers call bonds for many reasons, many of which are easy to understand. These include:

1. development of a business model;
2. de-leveraging, using cash generation or asset sales to reduce the issuing company's debt burden;
3. more attractive financing becomes available elsewhere;
4. a cheaper coupon is available on new debt;
5. a change of control; and
6. refinancing debt as major business milestones are achieved.

The last of these is the most common reason for debt to be called early but is also the least understood by investors. This paper is designed to help answer this common question that we receive from our clients. Why do high yield issuers call debt early, paying a premium, and even doing so to refinance at higher interest rates, when they could simply leave the bond to run to its final maturity?

High yield companies are generally focused on equity growth

To understand why high yield companies refinance it is important to understand how the capital structures of high yield companies generally differ from their investment grade counterparts.

High yield companies typically have more debt in their capital structure than equity, and investment grade companies the opposite, with a hypothetical example outlined in Table 1.

High yield companies have more debt, but the debt is usually there to enhance the equity return.

Generally, a high yield company is seeking to make a return on equity well in excess of the underlying rate of economic growth over a five-to-seven-year time horizon. The aim is generally to create a larger, more profitable company that can then be sold at the end of this period, achieving a profit for the equity owner.

TABLE 1: AN ILLUSTRATIVE CAPITAL STRUCTURE

	High yield	Investment grade
Debt	$150m	$70m
Equity	$50m	$130m
Total capitalisation	$200m	$200m

There are many ways that a business can seek to achieve high rates of growth. Growth can come from expanding existing operations; for example, opening new stores or production facilities, buying a competitor or assets from a competitor to accelerate the expansion, moving organically into a new fast-growing geography, or a combination of these things.

Often, management will pursue a multi-faceted approach to achieving their goals over longer time frames.

1 Investment Managers are appointed by BNY Mellon Investment Management EMEA Limited (BNYMIM EMEA), BNY Mellon Fund Managers Limited (BNYMFM), BNY Mellon Fund Management (Luxembourg) S.A. (BNY MFML) or affiliated fund operating companies to undertake portfolio management activities in relation to contracts for products and services entered into by clients with BNYMIM EMEA, BNY MFML or the BNY Mellon funds.

Example: a gym company

Let's take a relatively simple hypothetical example – a gym company based in the UK. They issue a five-year bond with an 8% coupon, callable in two years at a price of 104 (i.e. the call premium is 4%). The gym operator might decide to accelerate its organic UK growth strategy with the acquisition of a competitor, seeking to expand its client base across the country. Once this strategy is executed, expansions into other geographical regions may move into focus.

As the group's membership reaches a critical mass, it decides to launch an app, offering a subscription service to members for health advice.

Let's say that this theoretical gym company started off with profits of £100m per annum on its UK business. After buying its competitor and benefiting from some cost saving synergies, the company has been able to boost its profit to £120m two years later. With this milestone achieved, management want to focus on overseas expansion plans and ensure they have the funding in place to execute this next stage of their business plan.

They are able to use their higher profit base to borrow more easily, so they make a decision to refinance, issuing new debt and calling their old debt. The five-year bond is called at 104, and investors receive an effective return of close to 10% per annum for the two years they have been invested.

The small premium payable to call the debt is insignificant compared to the flexibility they gain from guaranteeing that funding is in place through the next stage of their development.

Given their greater size and profitability, they can issue a new five-year bond with a lower coupon of 7%, this time callable in three-years' time, but with a lower call premium of 103.5.

Time rolls on, and three years later the overseas expansion is well underway, with the gym group a successful multinational with profits of £170m per annum.

With another major milestone achieved, management now want to develop an app to measure health statistics such as blood pressure, oxygen levels and body mass index. This would be available to members for a small additional fee but requires investment to develop and a marketing budget to promote it over a two-year period. They choose to once again call their bond, and this time investors receive a return of just over 8% per annum for the three years they have been invested.
The company then issues a new five-year bond, with a 6.5% coupon, callable in two years at 103.

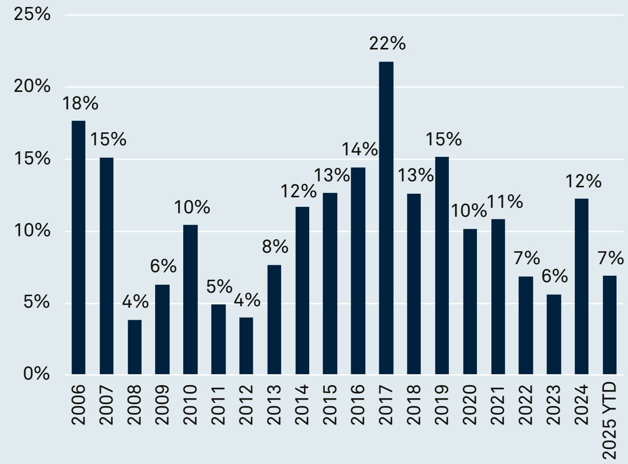
After the app is rolled out, and marketed, profits rise to £190m over the following two years. Once again, as the company passes another important milestone it makes sense for management to refinance. They choose to once again call their bond, and this time investors receive an effective return of just under 8% per annum for the two years they have been invested.

From the equity owner's perspective, profits at the company have grown from £100m to £190m over a seven-year period. This is an internal rate of return (IRR) of 9.6%, growth well in excess of GDP and on track to make a double-digit return on equity. We generally see equity owners selling companies after a five to seven year holding period where a double-digit IRR has been achieved – that is how the equity owner makes its money.

For the equity owner, the refinancing premium is a minor consideration. Their focus is on achieving long-term growth to position the company for sale. With a 9.6% IRR, higher interest rates are not a deterrent – securing financing through critical phases takes precedence.

Figure 1 shows call rates relative to yields in European high yield markets. On average, 10% of issues are called per annum and, although this does vary with funding costs, issuers were still calling bonds, admittedly at subdued levels, even when rates spiked upwards during the global financial crisis.

FIGURE 1: PERCENTAGE OF EUROPEAN HY CALLED PER ANNUM



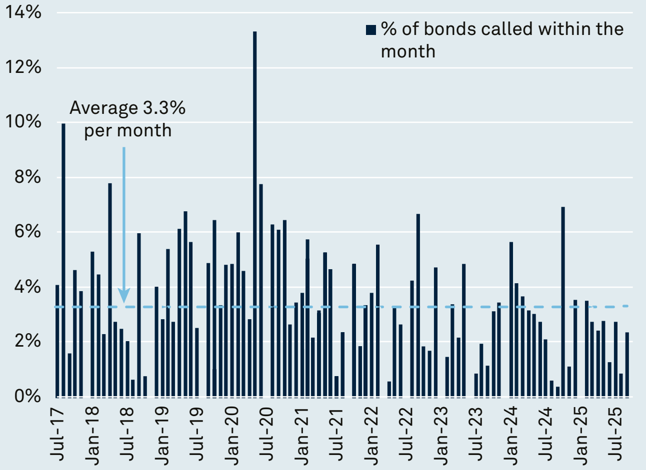
Source: Data from JP Morgan on European high yield market, as of 30 September 2025. JPM creates its own indices to monitor the size of financial instruments based on internal data.

Exploiting call premiums

The short-dated nature of Insight's high yield strategy, combined with an investment process focused on visible cashflows, means we believe we are well positioned to exploit call premiums.

Our analysts meet companies up to six times each year. We seek to understand how the current business plan is developing versus our internal forecasts and often what the next stage of the business plan could be. We can track when the business plan is performing as expected and therefore when a bond is likely to be refinanced. This has resulted in a solid track record of investing in bonds that are refinanced. As can be seen in Figure 2, on average 3.3% of our strategy has been refinanced every month, and generally between 35% to 50% of the strategy has been redeemed each year.

FIGURE 2: % OF INSIGHT'S GSDHY STRATEGY REFINANCED MONTHLY



Source: Insight, as at 30 September 2025. The representative portfolio adheres to the same investment approach as Insight's global short dated high yield bond strategy. Portfolio inception date November 2016.

The value of investments can fall. Investors may not get back the amount invested. Income from investments may vary and is not guaranteed.

BNY | INVESTMENTS