**CORPORATE FINANCE**

**Learning Outcome 2: ACTIVITY 5**

## **Bond financing**

A bond represents a loan made by investors to the issuer. In return for this investment, the investor receives a legal claim on future cash flows of the borrower.

#### The formula for the valuation of a redeemable bond is:

#### P0 = $\left(\frac{I}{(1+Kd)}\right)+\left(\frac{I}{(1+Kd)2}\right)+\left(\frac{I}{(1+Kd)3}\right)+…+ \left(\frac{I+RV}{(1+Kd)n}\right)$

#### Where:

#### PO = ex-market rate of interest

#### I = interest paid ($)

#### Kd =rate of return required by debt investors (%)

#### RV = redemption value ($)

#### n = time to maturity (years)

Consider a bond that pays annual interest of 10% and that is redeemable at a nominal value of $100 in four years’ time. Assume that investors in this bond require an annual rate of return of 12%.

#### Required: in small groups

1. Identify and explain the nature of the ‘promises’ that are made by the issuer of bond financing.
2. Explain the meaning of ‘nominal yield’ in the context of bond financing.
3. Calculate the value of the bond.
4. Consider your chosen business (from Activity 1, etc) and its use (or potential use) of bond financing. Explain the extent to which bond financing might provide advantages for your chosen business.
5. Prepare a short presentation on your findings.