Long-Term Debt: Bonds

Two ways to finance corporations:

1. Debt: Purchases on account and issuing bonds or notes payable.
2. Equity: Issuing common and/or preferred stock.

Earnings Per share (EPS): Measures income earned in terms of common stock outstanding.

EPS =   (Net income – Preferred Dividends) / Number of Common Shares of stock outstanding

<u>Bond Types:</u>

Bond Indenture (also known as Trust Indenture): Contract between the bond issuer and the bond holder.

Callable Bonds: Right to redeem bonds before their maturity date.

Callable less than 100% → Gains
Callable greater than 100% → Losses

Convertible Bonds: Bonds that can be exchanged for other securities like common stock.

Debenture Bonds: Bonds issued based on the general credit of the corporation.

Term Bonds: Bonds that all mature at the same time. Example: $1,000,000 of term bonds might all mature four years from today.

Serial Bonds: Bonds that mature in installments at regular intervals. Example: $1,000,000 five-year seria bond may mature in $200,000 annual installments over a five year period.

<u>Terms</u>:

Face Value: The amount due at maturity
Interest Rate:

1. Contract Rate of the bond (AKA Coupon Rate)
2. Market Rate of the bond (AKA Effective Interest Rate) is determined from the sales and purchases of similar bonds

Contract Rate = Market Rate → Issued at face value

Contract Rate > Market Rate → Issued at a premium

Contract Rate < Market Rate → Issued at a discount

Discount on Bonds Payable: Contra Liability (normal balance = debit)
Premium on Bonds Payable: Adjunct Liability (normal balance = credit)