

Chapter – 14: Long-Term Financing: An Introduction

Questions and Problems section

8. Long-Term Debt: [

Solution: Making a few assumptions like no brokerage, transaction charges, etc.

(a) Cash flows and rate of return for PBS Srinivas would be:

Time	Amount		
Nov-96	-5000		
Dec-96	0		
Jan-97	0		
Feb-97	0		
Mar-97	279.17		
Apr-97	0		
May-97	0		
Jun-97	0		
Jul-97	0		
Aug-97	0		
Sep-97	418.75		
Oct-97	0		
Nov-97	0		
Dec-97	0		
Jan-98	0		
Feb-98	0		
Mar-98	418.75		
Apr-98	0		
May-98	0		
Jun-98	0		
Jul-98	0		
Aug-98	0		
Sep-98	418.75		
Oct-98	0		
Nov-98	0		
Dec-98	0		
Jan-99	0		
Feb-99	0		
Mar-99	418.75		
Apr-99	0		
May-99	0		
Jun-99	0		
Jul-99	0		
Aug-99	0		
Sep-99	418.75		
Oct-99	0		
Nov-99	0		
Dec-99	0		
Jan-00	0		
Feb-00	0		
Mar-00	418.75		
Apr-00	0		
May-00	0		
Jun-00	0		
Jul-00	0		
Aug-00	0		
Sep-00	418.75		
Oct-00	0		
Nov-00	0		
Dec-00	0		
Jan-01	0		
Feb-01	0		
Mar-01	418.75		
Apr-01	0		
May-01	0		
Jun-01	0		
Jul-01	0		
Aug-01	0		
Sep-01	5,410.25	Monthly return	1.35%
Oct-01		Yearly returns	17.45%

(b) The cash flows and rate of return for Vinod Naredi would be:

Sep-01	-4,991.50	Monthly return	1.47%
Oct-01	0	Yearly returns	19.17%
Nov-01	5139.58333		

(c) The reason for the sudden crash in prices is due to the fact that the company had decided to use the call option and redeem the bonds at the end of five years when the interest rates were low and the bond was giving high coupon rates.