

---

# What is a corporate bond?

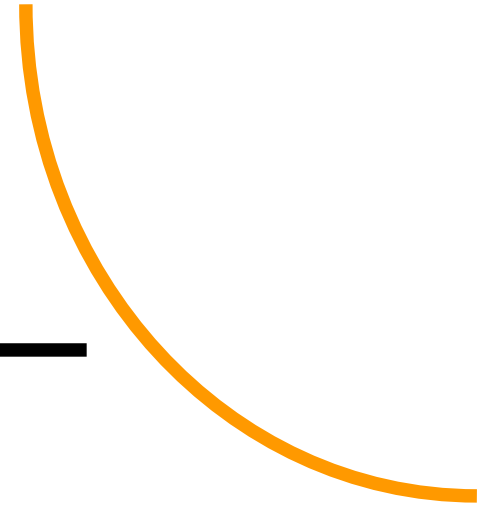
# Corporate bonds

---

- Corporate bonds are loans where you become lender to a company or institution
- The company promises to pay you interest on the loan until it is repaid
- They promise to pay back the loan on a fixed date in the future
- Corporate bonds are also referred to as
  - Fixed income
  - Fixed interest
- Gilts are corporate bonds issued by the UK Government

# Corporate bonds

---



Acme Industries, 7.25pc, 08

Company issuing  
the bond

Interest rate or  
'coupon'

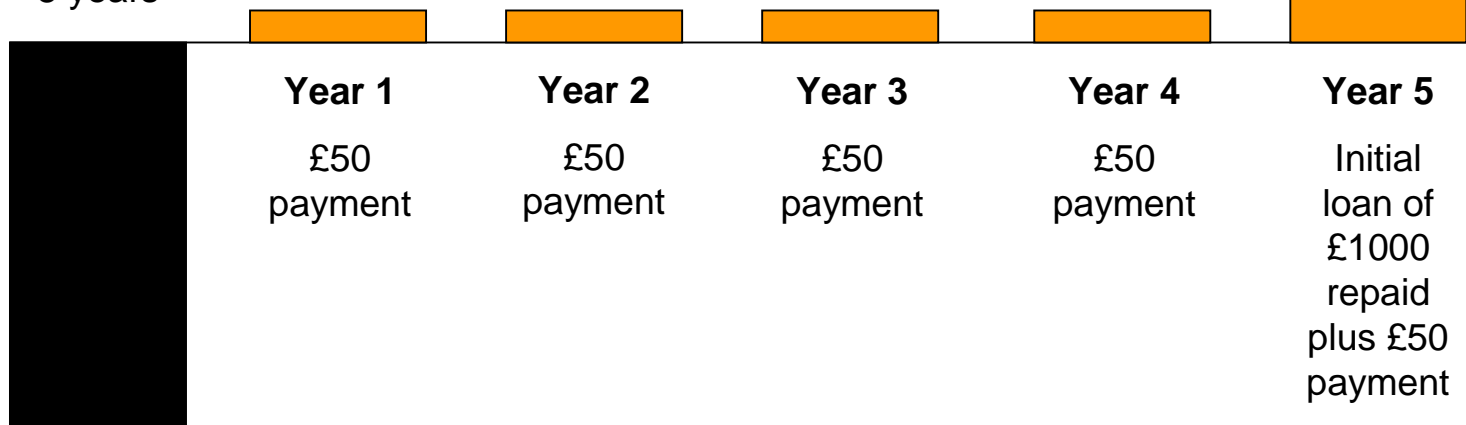
year of repayment /  
maturity

# How a bond works

---

- £1000 in a 5 year bond with a coupon of 5.0%

You loan  
£1000 for  
5 years



# Types of bond

---

- Government bonds (in the UK, also known as gilts)
  - Generally the safest form of bond if issued by a developed nation
- Corporate bonds (those issued by companies)
  - Safety depends on how secure the company is
  - Larger established firms are less likely to default on their payments
- Convertible bonds
  - A bond with the option to convert to an equity at some point in the future
- Index linked bond
  - A bond whose coupon and/or capital repayment are tied to the rate of inflation

# Risk and reward

---

- There are risks involved:
  - The company may default on their regular interest payments
  - The company may be unable to repay the capital at maturity
- Either way, the investor can lose out
- Corporate bonds therefore tend to pay more than a bank or building society
- The higher risk/more debt the company carries, the higher the interest rate they pay to attract investors

# Bond ratings

---

- Corporate bonds are generally rated by independent agencies (Moody's and Standard & Poor's)
- This gives an opinion about how risky they are
- AAA or Aaa is the highest available
- Lower risk bonds are termed 'Investment Grade'
- Higher risk bonds are termed 'Non-investment Grade'

Investment grade		Sub-investment grade	
Moody's	S&P	Moody's	S&P
Aaa	AAA	Ba	BB
Aa	AA	B	B
A	A	Caa	CCC
Bbb	BBB	Ca	CC
		C	D

# Corporate bond pricing

---

- Bond prices are affected by interest rates
- If interest rates **rise** then bond prices will **fall**
  - as interest rates rise the fixed rate paid on the bond will become less attractive
  - Demand for the bond will fall and prices will fall
- However, If interest rates **fall** then bond prices will **rise**
  - As interest rates fall, the amount paid on a bond becomes more attractive
  - Demand for the bond will rise and prices will rise as well