

On May 31, 2017, Core Company Issued 1,000, 14%, 10-year \$1,000 Bonds At 105. Each Bond Was Issued With

Introduction

On May 31, 2017, Core Company issued 1,000, 14%, 10-year \$1,000 bonds at 105. Each bond was issued with several important features that reflect the company's capital raising strategy, the terms of the debt, and the implications for its financial statements. Understanding the details of bond issuance is crucial for analyzing a company's financial health, debt management, and investor relations. This article provides an in-depth exploration of this bond issuance, covering the specifics of the issuance, accounting treatment, and financial implications.

Details of the Bond Issue

Bond Characteristics

- **Number of Bonds Issued:** 1,000 bonds
- **Face (Par) Value per Bond:** \$1,000
- **Interest Rate (Coupon Rate):** 14% annually
- **Term:** 10 years
- **Issue Price:** At 105, meaning 105% of face value

Pricing and Premium

The bonds were issued at 105, which indicates a premium over the face value. This means each bond was sold at 105% of its face value, equating to \$1,050 per bond. The premium arises because the bonds' stated interest rate (14%) was likely higher than the prevailing market interest rates at the time, making them attractive to investors.

Total Proceeds from the Bond Issue

1. Calculation of gross proceeds:

- Number of bonds: 1,000
- Issue price per bond: \$1,050
- Total proceeds: 1,000 bonds × \$1,050 = \$1,050,000

2. Less: Bond issuance costs (if any):

These costs are deducted from gross proceeds to determine net proceeds.

Accounting for the Bond Issuance

Recording the Bond Issuance

When Core Company issues bonds at a premium, the company records the transaction to reflect the cash received and the liability incurred. The journal entry on May 31, 2017, would typically be:

Dr. Cash \$1,050,000
Cr. Bonds Payable \$1,000,000
Cr. Premium on Bonds Payable \$50,000

Key points:

- **Bonds Payable:** Represents the face value of the bonds issued.
- **Premium on Bonds Payable:** The excess over face value, which amortizes over the life of the bonds.

Amortization of Bond Premium

The premium on bonds payable is amortized over the bonds' lifespan, reducing the interest expense recognized each period. The straight-line method or the effective interest method can be used, with the latter being more accurate.

- **Effective interest method:** Calculates interest expense based on the book value of the bonds and the market rate of interest at issuance.

- **Impact on financial statements:** The amortization decreases the premium account and increases interest expense over time.

Interest Payment and Expense Recognition

Every year, Core Company will pay interest at 14% of the face value, which is \$1,000 per bond, totaling:

- Annual interest per bond: $\$1,000 \times 14\% = \140
- Total annual interest expense (assuming straight-line amortization):
- For 1,000 bonds: $\$140 \times 1,000 = \$140,000$

Under the effective interest method, the actual interest expense recognized will be slightly different due to the amortization of the premium.

Financial Implications of the Bond Issue

Impact on the Balance Sheet

The issuance increases the company's liabilities and cash assets. The bonds payable are recorded at face value, adjusted for the premium, which appears as a separate component on the liabilities side. Over time, as the premium is amortized, the book value of bonds payable decreases toward the face value.

Impact on the Income Statement

The interest expense recognized each period influences net income. Since the bonds were issued at a premium, the actual interest expense is lower than the coupon payment, reflecting the amortization of the premium.

Impact on Cash Flows

Interest payments are cash outflows, totaling \$140,000 annually. The initial cash inflow from the bond issuance is \$1,050,000, providing the company with capital for operations, expansion, or debt refinancing.

Advantages of Issuing Bonds at a Premium

- **Lower Effective Interest Expense:** The premium reduces the overall interest expense over the life of the bonds.
- **Attractive to Investors:** Higher coupon rate compared to market rates makes bonds more appealing.
- **Flexibility in Financing:** Bonds can be issued to raise significant capital without diluting ownership.

Potential Risks and Considerations

- **Interest Rate Risk:** Market interest rates could rise, making the bonds less attractive, affecting future refinancing options or bond prices if sold before maturity.
- **Refinancing Risk:** At maturity, the company must repay the face value of \$1,000, potentially requiring new debt at prevailing rates.
- **Impact of Premium Amortization:** Overestimating the premium amortization can distort financial analysis if not properly accounted for.

Conclusion

The issuance of 1,000 bonds at 105 with a 14% coupon rate and a 10-year maturity represents a strategic move by Core Company to raise capital efficiently. By issuing bonds at a premium, the company benefits from lower effective interest costs while providing attractive yields to investors. Proper accounting for the premium and interest expense ensures accurate financial reporting and analysis. Understanding the nuances of bond issuance, including the pricing, accounting treatment, and financial impact, is essential for stakeholders to assess the company's financial health and long-term viability.

Frequently Asked Questions

What was the face value of each bond issued by Core

Company on May 31, 2017?

Each bond had a face value of \$1,000.

What was the coupon rate of the bonds issued by Core Company?

The bonds had a 14% coupon rate.

For how long was the maturity period of the bonds issued on May 31, 2017?

The bonds had a 10-year maturity period.

At what price were the bonds issued relative to their face value?

The bonds were issued at 105, meaning 105% of their face value, or \$1,050 per bond.

What does issuing bonds at 105 imply about the bond's premium or discount?

Issuing at 105 indicates the bonds were issued at a premium, above their face value.

How much total proceeds did Core Company receive from issuing 1,000 bonds at 105?

Core Company received \$1,050,000 in total proceeds (1,000 bonds × \$1,050).

What is the significance of each bond being issued with a 14% coupon rate?

It means each bond paid annual interest of \$140 (14% of \$1,000) to bondholders.

Why might Core Company choose to issue bonds at a premium (above face value)?

They might do so to attract investors by offering a higher yield or due to favorable market conditions.

What accounting entries would Core Company record upon issuing the bonds at 105?

They would record cash received (\$1,050,000), and a liability for bonds payable at face value (\$1,000,000), with the excess (\$50,000) recognized as a premium on bonds payable.

What are potential advantages for Core Company in issuing bonds at 105 instead of at par?

Issuing at a premium can lower the effective interest expense over the bond's life and can signal strong creditworthiness to investors.

Additional Resources

Core Company Bonds Issue on May 31, 2017: An In-Depth Analysis

On May 31, 2017, Core Company issued a significant financial instrument that would influence its fiscal landscape for the next decade: 1,000, 14%, 10-year \$1,000 Bonds At 105. This bond issuance not only reflects Core Company's strategic financial planning but also offers insights into market conditions, investor appetite, and the company's long-term capital management strategies. This comprehensive review delves into the details of this bond issuance, analyzing the terms, motivations, implications, and broader context surrounding this financial decision.

Understanding the Bond Issuance: The Basics

Before exploring the specifics of Core Company's bonds, it is essential to comprehend the fundamental concepts involved:

- Bond Face Value (Par Value): The amount paid back to the bondholder at maturity, here \$1,000.
- Coupon Rate: The annual interest rate paid to bondholders, here 14%.
- Term: The duration until maturity, here 10 years.
- Issue Price (At 105): The bonds were issued at 105% of face value, indicating a premium.
- Number of Bonds Issued: 1,000 bonds.

The Core Details of the May 31, 2017 Bond Issue

Quantity and Denomination

Core Company issued a total of 1,000 bonds, each with a face (par) value of \$1,000, totaling \$1,000,000 in principal. This sizable issue reflects the company's intent to raise substantial capital for expansion, refinancing, or other corporate needs.

Interest Rate and Payment Structure

The bonds carry a 14% annual coupon rate, meaning each bond pays \$140 annually (14% of \$1,000). Given that bond interest is typically paid semiannually, investors would receive two payments of \$70 each year.

Term and Maturity

With a 10-year maturity, investors are assured of receiving interest payments over a decade, with the principal amount of \$1,000 per bond returned at the end of this period.

Issue Price and Premium

The bonds were issued at 105, which means 105% of face value, or \$1,050 per bond. This indicates investors paid a premium of \$50 per bond above the face value, totaling \$50,000 in additional proceeds for Core Company.

Motivations Behind the Bond Issuance

Understanding why Core Company chose to issue bonds at this specific time involves analyzing both internal strategic objectives and external market factors.

Funding Growth and Expansion

A primary motive for issuing bonds is often to raise capital without diluting

ownership through equity issuance. Core Company may have been planning significant investments—such as new facilities, acquisitions, or product development—that required substantial funding.

Refinancing Existing Debt

Alternatively, the company might have sought to refinance higher-interest debt, taking advantage of favorable market conditions to lock in lower borrowing costs or improve cash flow.

Market Conditions Favorable for Bond Issuance

In 2017, interest rates in the U.S. remained relatively low, encouraging corporations to issue debt at attractive terms. The premium at issuance (105) indicates strong investor demand, possibly driven by the company's creditworthiness and favorable market sentiment.

Market and Investor Perspectives

Why Did Investors Pay a Premium?

Issuing bonds at 105% suggests investors were willing to pay more than face value for a 14% coupon, which might seem counterintuitive given the high coupon rate. Several factors could explain this:

- **Market Demand for High-Yield Bonds:** Investors seeking higher returns might have been drawn to Core Company's bonds if they perceived the company's credit risk as low.
- **Interest Rate Environment:** The prevailing interest rates might have made the bonds attractive compared to other investment options.
- **Investor Confidence:** The premium reflects confidence in Core Company's financial stability and growth prospects.

Implications of the Premium

The premium impacts the effective yield for investors:

- **Yield Calculation:** Although the coupon rate is 14%, the premium reduces the yield to maturity (YTM). Essentially, investors pay \$1,050 but receive \$1,000 at maturity, along with interest payments.

- **For Core Company:** The premium results in higher proceeds upfront, but it also indicates the company must pay interest on a higher principal basis—unless the premium is amortized over the life of the bonds.

Accounting and Financial Reporting Aspects

The bond issuance affects Core Company's financial statements in several ways.

Initial Recognition

- The company records the cash received at the issue price: 1,000 bonds × \$1,050 = \$1,050,000.

- Since bonds are issued at a premium, the excess over face value (\$50,000) is recorded as Premium on Bonds Payable, a liability that is amortized over the bond's life.

Amortization of Premium

- Over the 10 years, the premium is systematically amortized, reducing interest expense and increasing net income.

- The amortization method (straight-line or effective interest) impacts the company's reported interest expense each period.

Interest Expense Recognition

- **The company pays \$140,000 annually in coupon payments.**

- **The interest expense reported in financial statements depends on the amortization schedule,**

which affects net income and taxable income.

Impact on Financial Ratios

- The issuance at a premium improves debt-to-equity ratios and interest coverage ratios, influencing creditworthiness assessments.

Implications for Core Company's Financial Strategy

This bond issuance illustrates several strategic considerations:

- **Leverage Management:** Issuing bonds increases leverage, providing capital for growth but also increasing fixed obligations.
- **Cost of Debt:** The effective interest rate, considering the premium and amortization, impacts overall borrowing costs.
- **Investor Relations:** The successful issuance with a premium indicates strong investor confidence, potentially enhancing the company's reputation.
- **Long-Term Planning:** With a 10-year horizon, Core Company commits to a decade of fixed interest payments, aiding in financial planning and

stability.

Potential Risks and Challenges

Despite the apparent success of the bond issuance, several risks warrant discussion:

- Interest Rate Risk:** If market rates rise, the fixed-rate bonds could become less attractive, impacting the company's ability to refinance or issue new debt.
- Refinancing Risk:** As the bonds mature in 10 years, the company faces the risk of unfavorable market conditions when refinancing.
- Credit Risk:** If Core Company's financial health deteriorates, the bonds could become riskier, potentially affecting its credit rating and borrowing costs.
- Premium Amortization Impact:** The amortization of the premium reduces interest expense over time, but misestimations could affect reported earnings.

Conclusion: A Strategic Financial Move

The May 31, 2017 bond issuance by Core Company exemplifies a carefully calibrated financial strategy, balancing the need for capital with market conditions and investor confidence. Issued at a premium with a substantial coupon rate and long-term maturity, these bonds reflect a company confident in its growth trajectory and able to secure favorable financing terms.

For investors, the bonds represented a high-yield opportunity, backed by a company willing to pay a premium to attract capital. For Core Company, the issuance provided a critical infusion of funds to support strategic initiatives, while also establishing a stable debt profile to be managed over the coming decade.

As with all corporate debt, ongoing management of interest obligations, market conditions, and company performance will determine the ultimate success of this financial move. In the broader context of corporate finance, such bond issues are instrumental in shaping a company's growth story, illustrating the delicate interplay between risk, return, and strategic foresight.

In summary, the bond issuance by Core Company on May 31, 2017, is a rich case study in corporate financing, highlighting the importance of market timing, investor relations, and prudent financial management. It underscores how companies leverage debt markets to fuel expansion and how investors

evaluate the risks and rewards of high-yield bonds issued at premiums.

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