Review Material for Test 1B: Time Value of Money, and Valuation of Bonds/Fixed Income Instruments

Three sources of Financing for the Firm –

Internal: Retained Earnings

External, Fixed Cost Source: Bonds

External, Variable Cost Source: Stocks

Understanding that Depreciation is NOT a Cash source of financing for the firm

Difference between the source of financing used to fund a project versus the significant feature of making a sound business decision – the method of financing does not determine whether you have made a sound business decision in terms of receiving outstanding value for the price paid for assets, another business, real estate, etc.

Differences in the present value of cash flows based on the timing of when payments are to be received

[e.g. annuity due versus annuity immediate, payment pattern differences between to uneven cash flows]

How bonds are sold in a primary market transaction – face or par value, the coupon rate is adjusted to reflect risk and market rates of interest, specifies time when payments will be made

Calculation of Present Value, as well as, Future Value of a Lump Sum

Knowledge of the Amortization Schedule

Differences in default risk on bonds based on issuer

Number of years to increase the value of an investment at a given rate of return

Yield to maturity on a coupon bond, as well as, a zero coupon bond

Calculation of the present value or future value of an annuity due, in addition to an annuity immediate or ordinary annuity

Calculation of the present value of an uneven cash flow stream at a given rate of interest