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New EDHEC-Risk Institute research affirms that issuing inflation-linked bonds substantially increases firm value

In a climate of increasing inflation uncertainty, EDHEC-Risk Institute has released a new study analysing optimal corporate debt management policies. The study, produced as part of the research chair on "The Case for Inflation-Linked Corporate Bonds: Issuers' and Investors' Perspectives," in partnership with Rothschild & Cie, entitled "**Optimal Design of Corporate Market Debt Programmes in the Presence of Interest-Rate and Inflation Risks**," examines the optimal liability structure when the issuer faces such instruments as fixed-rate debt, floating-rate debt, and inflation-linked debt.

The authors of the study, Lionel Martellini, Scientific Director, and Vincent Milhau, Senior Research Engineer, EDHEC-Risk Institute, introduce a general framework with which a corporation subject to default risk may make optimal debt-management decisions.

The main findings of the study are the following:

* Debt management has an impact on capital structure. A primary contribution of the paper is to provide a joint quantitative analysis of capital-structure decisions and debt-structure decisions within a standard continuous-time model in the presence of interest-rate and inflation risks.
* An optimal debt structure can facilitate substantial increases in firm value. Issuing floating-rate bonds or inflation-linked bonds may increase risk from the perspective of pure debt management, but it may decrease risk from the perspective of integrated asset/liability management. From this trade-off emerges an optimal debt structure, and one can show that under mild simplifying assumptions, minimising the volatility of assets nets of liabilities is equivalent to minimising the risk-adjusted probability of default, which is in turn equivalent to maximising firm value.
* A number of corporations would benefit from issuing inflation-linked bonds, bonds usually associated with sovereign states. If a firm's revenues grow with inflation, issuing some inflation-linked debt can be a natural hedge.

A copy of the study can be downloaded via the following link:

EDHEC-Risk Publication Optimal Design of Corporate Market Debt Programmes in the Presence of Interest-Rate and Inflation Risks

This study was produced as part of the research chair on "The Case for Inflation-Linked Corporate Bonds: Issuers' and Investors' Perspectives" in partnership with Rothschild & Cie.

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About EDHEC-Risk Institute

EDHEC-Risk Institute is part of EDHEC Business School, one of Europe's leading business schools and a member of the select group of academic institutions worldwide to have earned the triple crown of international accreditations (AACSB, EQUIS, Association of MBAs). Established in 2001, EDHEC-Risk Institute has become the premier European centre for financial research and its applications to the industry. In partnership with large financial institutions, its team of 66 permanent professors, engineers and support staff implements six research programmes and eleven research chairs focusing on asset allocation and risk management in the traditional and alternative investment universes. The results of the research programmes and chairs are disseminated through the three EDHEC-Risk Institute locations in London, Nice and Singapore.

EDHEC-Risk Institute validates the academic quality of its output through publications in leading scholarly journals, implements a multifaceted communications policy to inform investors and asset managers on state-of-the-art concepts and techniques, and forms business partnerships to launch innovative products. Its executive education arm helps professionals to upgrade their skills with advanced risk and investment management seminars and degree courses, including the EDHEC-Risk Institute PhD in Finance.

www.edhec-risk.com

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Rothschild Global Financial Advisory is involved in providing impartial and expert M&A and strategic advice as well as financing and restructuring advice across the range of equity and debt capital markets. Rothschild & Cie Gestion is the asset management arm of the Rothschild Group in France.

Rothschild & Cie Gestion manages EUR 22bn in assets and offers a diversified product range, with expertises in equities (focusing on European equities), bonds (including govies, Euro credit and European convertibles), balanced management, and long-only as well as alternative multi-management.