Raising Debt Capital

Few things to be noted on debt capital:

1. Companies that borrow money are obligated to
    a. Make regular interest payments
    b. Repay the principal at maturity (fixed-term)
2. Interest payments are tax-deductible
3. There is default risk (firms "run-away" or "default" on their obligations), where upon default, lenders will take over the firm's assets
4. Lenders have NO voting power, but protected by **covenants**

Covenants A specific contract that is designed to protect interests of lenders that is aimed at the borrower

Negative Covenants (Restrictive)	**Positive Covenants (Affirmative)**
Limit access to further debt	Maintain assets (working capital)
Restrict holdings of certain investments	Provide audited financial statements
Restrict dividends paid	

Types of Debt Bank loans and Debt securities

Bank Loans
Loan is a type of debt which the lender lends the money, and the borrower borrows it. Typically, in bank loans, the lender is the bank.

Debt Securities
Debt securities' example are commercial paper (bond), debentures, corporate bonds. This type of bond is where the public acts as the lender.

Additionally, debt securities or bond have a market where firms can exchange/trade bonds that is about to mature to get immediate cash.

Debt vs Equity Payoffs

"Equity + Debt = Firm Value"

The statement above is true, because if we look at the graph of the cash flow to the firm vs payoff to stockholder/debtholder, we could find the following:

As firms are obliged to pay debtholder's interest first (or experiencing default), therefore, the payoff that debtholder received in respect to the cash inflow the firm received could be created as follows:

As firms are obliged to pay debtholder's interest first, therefore stockholder can only receive money only when the firm already paid all interest and principal of debt that they hold, that is: