



THE DEBT ANALYSIS FRAMEWORK

When Borrowing is Smart vs. Dangerous

This report is prepared strictly for educational purposes. It does not constitute investment advice. Investors must conduct independent due diligence. The author is not a SEBI-registered Research Analyst.



The Double-Edged Sword of Leverage

Used **Wisely**



Accelerates growth



Boosts Return on Equity (ROE)



Acts as a tax shield

The Golden Rule of Debt

Is the borrowed capital generating returns significantly higher than its cost?

Used **Carelessly**



Destroys equity



Bankrupts the company

Insight

The Bottom Line: Debt in itself is not bad. **WRONG** debt is bad. If borrowing increases Earnings = Good. If borrowing only increases Risk = Bad.

Anatomy of Liabilities: Not All Debt is Created Equal

Before measuring size, analyze the structure.

4. Structured/Convertible

Complex instruments.
Risk of equity dilution.



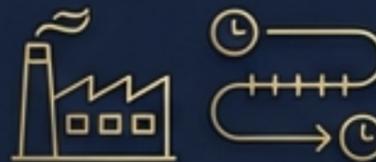
3. High-Cost Debt (Red Flag)

Unsecured loans or NBFC loans.
Insight: Indicates banks are refusing to lend.



2. Term Loans

Funds CAPEX (Plant, Machinery, Land).
Note: Structural long-term debt.



1. Working Capital Debt

Funds day-to-day operations
(Inventory, Receivables).
Rule: Should fluctuate with sales.



Industry Context

Manufacturing businesses
rely on Working Capital
financing; Service
businesses usually do not.



The FinReason 6-Step Debt Analysis Framework™

A standardized forensic model to stress-test any balance sheet.



The Solvency Check (Framework Steps 1 & 2)

Step 1: Debt-to-Equity Ratio



Total Debt ÷ Shareholder Equity



< 0.5
Conservative

> 2.0
Aggressive

Step 2: Interest Coverage Ratio (ICR)



EBIT ÷ Interest Expense



> 4 (Comfortable)

2 - 4 (Moderate)

< 2 (Risky)

Measures survival ability: Can operating profit pay the bank interest?

Quality & Trajectory (Framework Steps 3 & 4)

Step 3: The Trend Test



Trend analysis reveals efficiency and potential future stress.

Step 4: Purpose Analysis



Productive Debt



Buying machinery, creating capacity.

Investments that generate future income.



Unproductive Debt



Paying salaries, funding losses, luxury assets.

Expenses that destroy value and create fragility.



Cash Reality & Stress Testing (Framework Steps 5 & 6)

Step 5: Cash Flow Coverage

Operating Cash Flow (OCF)

- 1. Interest Payments
- 2. Principal Repayments

Rule: Net Profit is accounting opinion; Cash is fact. OCF must cover debt obligations.

Step 6: The 'What If' Scenario

Stress Test Simulation

Scenario:
Revenue Drops 20%



Can we still service interest?

Business owners think in downside scenarios; speculators think only in growth scenarios.



Forensic Application: Yashtej Industries (Pre-IPO)

FINANCIAL SNAPSHOT

Net Worth: ₹19.62 Cr

Total Borrowing: ₹43.85 Cr

EBITDA: ₹21.02 Cr



D/E Ratio:

2.23

AGGRESSIVE

CONFIDENTIAL

LEVERAGE ANALYSIS



Step 1 (Leverage): Debt is >2x Equity. High Risk Phase.



Step 2 (Purpose): Funds used for Manufacturing Plant & Working Capital. Verdict: Productive Debt.



Step 3 (Growth): Rapid expansion required inventory financing.

High leverage justifiable only because it funded productive capacity.

The Turnaround: Scale-Up then Clean-Up



Strategic Shift: The company used the public market to fix its private leverage problem. The question remains: Will future expansion require new debt?

The Verdict: Smart vs. Dangerous Debt

✓ Smart Debt / Wealth Multiplier



ROCE > Cost of Debt



Stable Cash Flows



Long Asset Life



Inelastic Demand

✗ Dangerous Debt / Equity Killer



Volatile Revenue



Weak Cash Conversion



Refinancing Dependence
(Ponzi Finance)

FinReason Insight

Leverage Magnifies Outcomes. In good times, Profits explode (ROE expands).
In bad times, Equity evaporates.

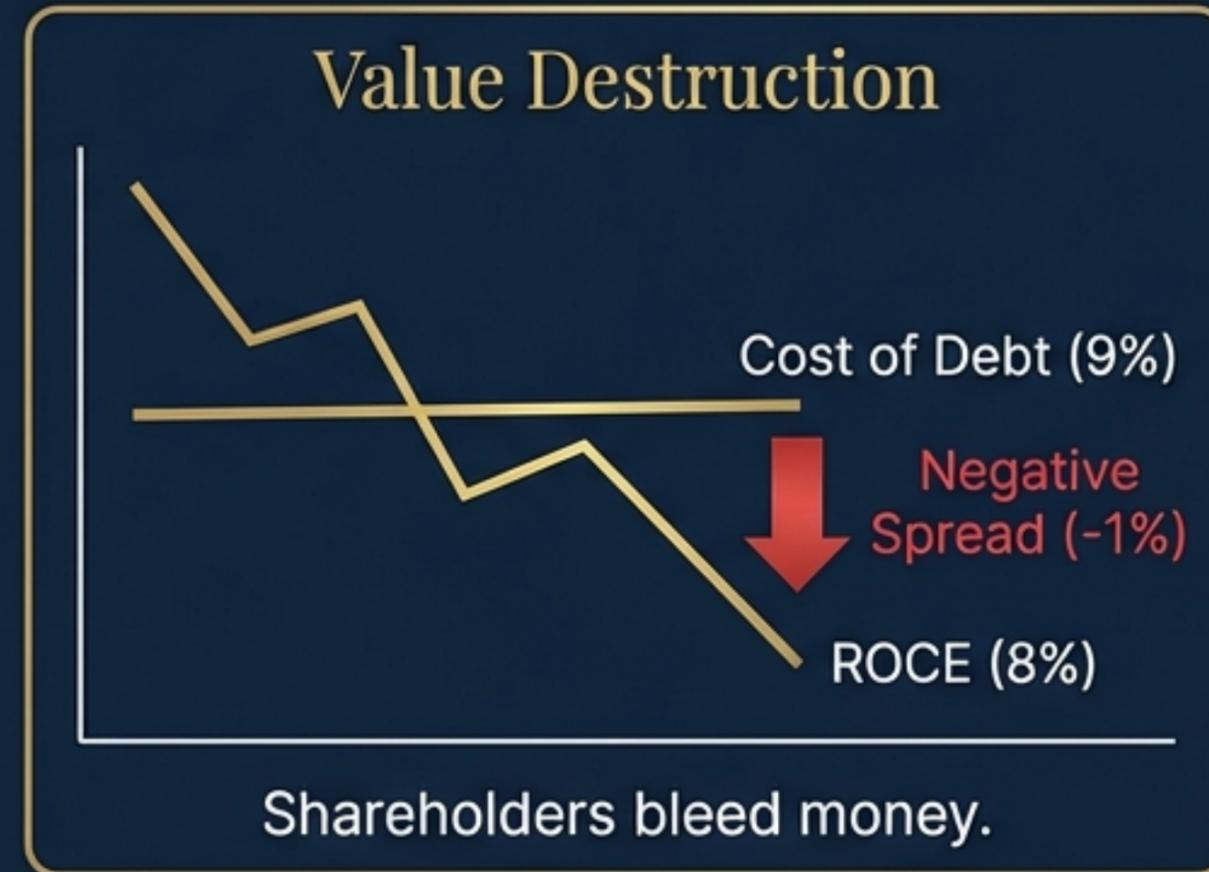
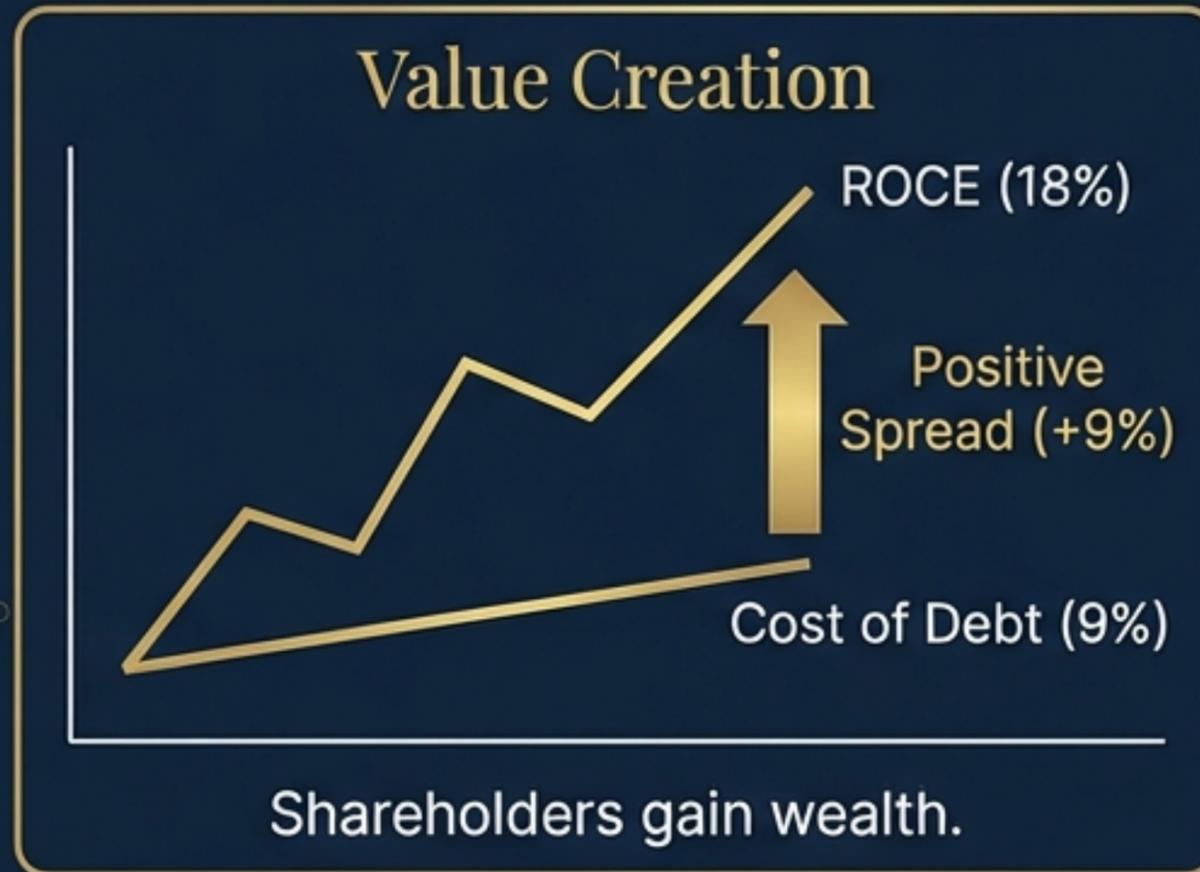




Advanced Forensics: The “Spread” Analysis

$$\text{Spread} = \text{ROCE} - \text{Cost of Debt}$$

The Jaws



The Trap: If margins compress, debt turns toxic immediately.

Capital Cycle Thinking



Smart management knows when to switch gears from Accumulation to Optimization.



The Capital Allocator's Final Checklist



Productivity: Is debt funding Capex (Growth) or Opex (Survival)?



Coverage: Is Interest Coverage Ratio comfortably above 3x?



Efficiency: Is Working Capital (Inventory/Receivables) under control?



Resilience: Can the business survive a 20% revenue drop?



Intent: Is management actively trying to De-leverage?



Speculators ignore debt. Serious investors analyze structure.

The Laws of Leverage

Equity creates Ownership.

Debt creates Acceleration.

But Uncontrolled Leverage destroys Both.

Handled wisely → Wealth Multiplier. Handled poorly → Equity Killer.