DATE 17 06 2021

Debt Market

If a co need capital, they can issue shares to the public where share holders will become the owners of the co... Co can share profits with them. Other option is to borrow the money from public by selling/issuing debentures to them where the co has to pay some interest and repay that money (principal borrowed) after some time like 3 years / 5 years

Govt also issue these debt instruments like Bonds if they need money to spend on infrastucture projects etc or if there is deficit in the budget (more exp than income). In this govt's also pay the interest for some period like 5/10 years and then repay the principal amount.

Investors who want to take less risk will invest in these debt securities since they will get fixed income as interest and get the principal amount back after some time so there is no risk of losing their principal amount (in Equity, investor may buy the shares for Rs.100, the share price may come down to rs.20 also if co makes losses, but that risk is not there in debt unless co default to repay)

If a co (bharti Airtel) issue debentures, the details will be as below

Money raised by the co	Rs 100 Cr
No. of debentures issued	1 Cr
FV per debenture	Rs. 100
issue date	15th June 2021
tenure	10 years
Maturity date	14th June 2031

DATE

coupon / interest ~~date~~ rate	10% per year
Interest payment frequency	Each year on 31^{st} dec.

In this Case, the investor will receive the money like below, if he invested in one debenture

Debentures purchased		1
money invested		Rs. 100
int amount		
	12/31/2021	Rs. 5 (Assume from July to Dec, 6 months)
	12/31/2022	Rs 10 } each year same amount
	12/31/2023	Rs 10.
	6/14/2031	105 on Expiry date, int from 2030 dec to june 2031 plus principal.

Generally, these debentures and bonds are issued at fixed rate interest / Coupon so amount of interest will not change and the repayment of principal / FV amount will be done at the end of the tenure. major risks for the investors are

1. Credit risk / risk of default - if the issuer (govt / co) defaults to repay
2. interest rate risk - if the interest rates in the market changes but investor is receiving old int rate like 10% in the above case.

while investing in debt securities, investors ~~like~~ will look in to the Credit risk / repayment Capacity of the issuer of debt securities. for this they can check the credit rating of the co that is issue by credit rating agencies like ICRA / FITCH / S&P etc. they give high rating like AAA to the stable co's like infosys / reliance etc, low rating like BB to co's like DHFL / yes bank etc

DATE

Co's with low credit rating has to pay higher interest since investors will invest their money in Co's with higher credit rating if both co's offer the same interest rate.

Eg: DHFL / future group etc borrow money by issuing debenture they pay 12% interest compared to 9% etc offered by a co like reliance.

Most of these debentures are also listed in a stock exchange so that the investors who gave money to the co can sell these debentures in the market if they need money. this is secondary market, means one investor is selling to another investor to get their money back.

Price of these debentures or bonds also changes in the market which means they are not always traded at FV like Rs 100 per debenture etc, it may trade at premium like Rs 105/110 or at discount like Rs. 95/90 etc.

Main reasons for changes in the market rate are

1. Change in the credit risk, if the co makes default on int or principal repayment, all investors will try to sell those debentures so MV will go down.

2. Change in interest rates, if the market interest rates are high now like 10%, the old debenture are paying low interest like 6%, then more investors want to buy new debenture since they are paying high int, so the market value of old debentures will go down to Rs. 90 etc.

There are many types of debentures/bonds in the market, depends on co requirement and investors interest / liking, different instruments are used in the market like convertible debentures, fixed rate debentures/ floating rate debentures, secured / unsecured etc

Fixed income securities include, debentures, bonds money instruments like certificate of deposit, commercial papers etc, mortgage backed securities, asset backed securities.

KEY TERMS

1. Face value (FV)

* This is the original value of Debenture/ Bonds, most of the times the co/ issuer will get this money on each debt instrument from the investor

eg: if Govt of india borrows 1L crores by issuing 1cr bonds @ 1,00,000 /bond, they will get Rs 1L on each bond from the investor.

* The issuer like Govt / company will pay coupon / int on this face value, even if the investor purchases this bond at Rs 1.20.000, still he will get interest on face value only

eg: if Govt of india is paying 6% int, the investor will get Rs 6000 per year even if he purchased at Rs. 90,000 / bond or at Rs. 1.10.000 per bond.

* At the time of redemption / repayment, the issuer will repay this amount to the investor who is holding this security on that date.

2. Coupon rate / interest rate

Each debt instrument/ ~~fixed~~ ~~deb~~ fixed income instrument have the coupon rate, rate at which they will pay the interest.

DATE

Generally, this amount is paid on semi-annual basis (6 months once). to the investor, However it can be monthly / quarterly / annual also.

Some type of bonds like zero coupon bonds (ZCB), pay the interest like along with principal repayment, there are no int payments in between the issue time and repayment time.

Eg: issue the bond at Rs.98 and repay Rs100 after 3 months, that Rs.2 is the interest in this case.

Most of the bonds / debentures pay the interest at fixed rates means if the rate of interest is fixed at 10%, tenure of the bond is 10 years, the co will pay that 10% in all those 10 years even though market int rates are changing

Most of the companies will try to borrow more when int rates are ~~below~~ like in 2020 (due to covid) so that they can pay low interest for a long period of time.

Tenure / Duration

Each debt instrument will have a specific life time / tenure like 5 years, 10 years, at the end of that tenure, the issuer will repay that amount to the investors.

Issuer can decide the tenure based on their requirement like 3 years / 5 years / 10 years etc. if the ~~tenure~~ tenure is more, they have to pay higher interest since investor thinks there is more credit risk / risk of default, interest rate risk (Getting low

int though market rate is high) in long tenure bonds than short tenure bonds
Eg:- if GOI borrows by issuing 10 year bonds they will offer 7%, for 5 year bonds they will offer 6% only

Maturity

This is the date/year when the bond/debt instrument will be repaid by the issuer

Most of the debt instruments will have a fixed tenure which means the maturity date is also fixed. Very few ~~instructions~~ instruments are issued as perpetual/irredeemable instruments which means they will not have a specific date for repayment, issuer may repay when they have money after some time like after 5 years. till the repayment will continue to pay interest.

Some types of bonds/debt instruments will have features where the repayment can happen much earlier than the original maturity date
Eg:- Callable bonds can be repaid by the issuer by calling from investors before the maturity. Similar way puttable bonds can be redeemed by investors any time by giving bonds to the issuer

Money market instruments will have less than one year tenure, they will be repaid in one year
Eg:- Certificate of deposits, Commercial papers etc are issued by banks, Co's etc for a short duration with a maturity period of less than 365 days. they will pay low interest.

All other debentures/bonds generally have 1 to 10 yrs tenure, few govt bonds will have longer tenue like 30 yrs. also,

DATE

Accrued Interest

Each debt instrument will have a different frequency to pay coupon / interest like monthly / quarterly / semi annual etc

for accounting purpose, the funds / investors will account in the income on a regular basis like daily or monthly etc, at that time they have to accrue the interest.

Eg: bond issued on 1/1/2021 at 10% int rate with FV of Rs 100 has annual int payments on 31/12/2021 they will pay Rs. 10 interest. if we are preparing books on 30/6/2021, we will accrue Rs. 5 as int receivable since it is guaranteed income and we will receive in dec 2021

Another reason to use this accrued interest and more popular reason is this accrued int is useful in deciding the sale price

Eg :- in the above Example, if we are selling the bond as of 30th june, 2021, there is accrued int in that Rs.5

~~st~~ so if the bond is sold for Rs. 105 it does not mean the seller made Rs. 5 profit rather he received Rs. 100 for bond and Rs 5 for accrued interest. in this case, accounting should be done to consider the sale value as 100 so no profit or loss on sale.