Module 6 – (ch24) Debt Financing

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Deadline and Submission: The written response must be submitted by **Saturday, October 4, 23h59**, exclusively through the **"Entrega de Atividades"** section on **eClass**. Late submissions will not be accepted. Your answer must be exactly **one full PDF page** (≈400–500 words).

Important Note: This activity must be prepared **individually and without the use of Artificial Intelligence tools**. Submissions showing AI-generated text will receive grade zero. The goal is to develop your own critical thinking and writing.

Disclaimer: This case is entirely **fictitious**. It does not necessarily reflect real financial data or strategies of Nova Energia S.A. or any other company.

Mini Case – Covenants in Debt Financing

Definition: *Covenants are contractual clauses included in debt agreements that restrict or oblige specific actions by the borrower, aiming to protect creditors from behavior that could increase default risk.*

Nova Energia S.A., a Brazilian renewable energy company, plans to issue **R$ 500 million in debentures** to expand its solar parks in the Northeast.

Institutional investors are willing to buy the bonds, but only if certain **restrictive covenants** are included in the contract:

- **Leverage Covenant**: Net Debt/EBITDA cannot exceed 3.5x.
- **Dividend Covenant**: The company cannot distribute more than 30% of net income as dividends per year.
- **Asset Sale Covenant**: The company cannot sell key operating assets without prior approval of bondholders.

Management is divided. The CFO argues that such covenants may **limit flexibility**, as the company operates in a volatile sector that sometimes requires taking on more debt or divesting assets.

The CEO, however, stresses that **accepting the covenants would reduce the cost of debt by 1.2% per year**, representing millions in savings over the 10-year maturity of the issue. The CEO is not entirely sure whether alternative funding options are available at this time.

This is therefore a decision with **real financial consequences**:
- With covenants → cheaper financing, but restricted flexibility.
- Without covenants → higher interest payments, but greater managerial freedom.

Your Task

As a financial consultant hired by Nova Energia S.A.:

1. Should the company **accept the proposed covenants** to secure the lower cost of capital, or **negotiate looser terms** even if interest costs rise?

2. Justify your recommendation by considering:
   - The role of covenants in protecting bondholders.
   - The potential impact on managerial flexibility and long-term strategy.
   - The financial trade-off between lower interest expense and operational constraints.

3. Provide a clear conclusion (yes/no to the covenants as written) with supporting arguments.

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