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CAPITAL ADVISORY

INVESTOR GUIDE

Debt vs Equity

A practical framework for founders evaluating financing alternatives without defaulting to equity dilution.

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The debt versus equity decision is rarely binary. Founders should evaluate cost of capital, flexibility, covenant constraints, dilution, and the strategic signal each structure sends to customers, employees, and future investors. Most companies at growth stage will use both instruments across their life, and the real question is sequencing: which capital funds which work, in what order, at what cost.

The framing error to avoid is comparing instruments on headline cost alone. Equity looks free because it has no coupon, and debt looks cheap because the interest rate is visible; both readings are wrong. Equity is the most expensive capital a growing company will ever sell, because its cost is a permanent share of every future dollar of value. Debt's visible rate omits covenant constraints, amortization pressure on cash flow, and the refinancing risk that arrives whether or not the business is ready. The honest comparison prices flexibility and downside behavior, not just the coupon line.

KEY FINDINGS

01 Debt fits recurring-revenue businesses funding identifiable ROI; equity fits unproven risk capital.

02 Covenants, dilution, and the signal each structure sends all belong in the comparison.

03 Hybrid structures often bridge the gap when neither pure debt nor pure equity fits cleanly.

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When Debt Fits

Recurring revenue businesses with predictable cash conversion can often support senior or unitranche debt at attractive terms. Debt works best when proceeds fund identifiable ROI, acquisitions with synergy cases, working capital for contracted growth, or refinancing at better terms. The unifying test is whether the funded activity produces cash flows that service the obligation on a timeline the instrument respects; debt against uncertain payback is equity risk wearing a credit structure.

Lender diligence differs from investor diligence in ways that reward specific preparation. Credit committees underwrite downside durability rather than upside: revenue contracted versus assumed, customer concentration, margin behavior in a stress case, and the quality of monthly financial reporting. A company that produces lender-grade reporting, thirteen-week cash forecasts, covenant headroom models, and clean management accounts, will price materially better than an identical business with investor-grade storytelling and accountant-grade numbers.

Covenants deserve as much negotiating attention as pricing. A cheap facility with tight maintenance covenants can become the most expensive capital on the balance sheet the first quarter the plan slips, because a covenant breach transfers negotiating leverage to the lender at exactly the wrong moment. Model covenant headroom under the downside case, not the base case, and treat any facility that only works if the plan is hit as mispriced regardless of its rate.

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When Equity Fits

Equity remains appropriate when the business needs risk capital for unproven initiatives, balance sheet repair, or market expansion where cash payback is uncertain. These are outcomes with wide distributions, and equity is the only instrument designed to absorb wide distributions. Using it for that purpose is not expensive; it is the instrument working as designed.

The right equity partner can also bring sector expertise and follow-on capacity, and these deserve genuine weight in partner selection. Follow-on capacity in particular functions as insurance: an investor who can and does lead the next round removes an entire financing risk from the company's future. Reference-check that behavior directly with portfolio founders, including at least one whose company underperformed, because follow-on behavior in bad quarters is the term that never appears in the term sheet.

Equity's true cost surfaces in structure more than price. Participating preferences, cumulative dividends, broad anti-dilution, and heavy protective provisions can convert a flattering headline valuation into a punishing exit waterfall. Model founder proceeds under at least three exit scenarios before signing anything; a modestly lower valuation with clean structure routinely outperforms a higher number wrapped in participation and ratchets.

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Hybrid Structures

Preferred equity, convertible instruments, and structured common can bridge gaps between pure debt and pure equity. These instruments exist because real financing problems are rarely pure: a company may be too levered for more debt but unwilling to price equity in a soft market, or need capital certainty now with valuation discovery deferred. The optimal structure depends on growth profile, existing leverage, and investor universe.

Each hybrid carries its own discipline. Structured preferred with PIK features preserves cash but compounds quietly, and founders should model the redemption stack at exit rather than at issuance. Convertibles defer the valuation conversation but stack up: three rounds of notes with different caps and discounts create a conversion event that surprises everyone at the priced round. Revenue-based instruments avoid dilution entirely but claim the same operating cash flow that funds growth, which limits them to businesses with genuine margin headroom.

The sequencing insight that ties the framework together is that instruments should match the maturity of what they fund. Prove the unproven with equity, finance the proven with debt, and use hybrids to bridge timing gaps rather than to avoid hard pricing conversations. Companies that let the risk profile of the funded work choose the instrument, rather than defaulting to whichever capital is easiest to raise that quarter, compound ownership meaningfully over a decade.

NEXT STEP

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Keningford Partners is a New York-based, principal-led capital advisory and M&A firm advising companies from Series A through the pre-IPO stage, alongside institutional investors, on equity, debt, and strategic transactions. Every mandate is led directly by senior bankers from origination through close.

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