Case 2: What would you interpret from the following statement in a company with source of capital as follows (Debt: 60%, Equity: 40%), While the WACC is 9%, Cost of Debt (Kd = -2% (negative 2%)), Cost of Equity (Ke = 36.8%).

The **Debt to Equity ratio** of **1.5** (**D/E** = 0.6/0.4) shows the company's dependence on debt for financing its capital, indicating leverage and risk. However, whether this ratio is favorable or unfavorable depends on factors like the company's growth stage, industry, and sector dynamics.

The **Cost of equity** is the return that the shareholders and investors expect to receive for taking risks and investing in the company. According to the data provided, the **cost of equity (Ke)** is **36.8%**, which is quite high. This indicates that investors and shareholders expect a high return of around **36.8%** on their holdings in compensation for the risk they are taking by investing in the company.

The **Cost of debt** refers to the effective interest a company pays on its debts, like bonds and loans. As per the statement, **Kd is -2%**, which is quite unusual as it is generally positive or, in some cases, zeros. Negative interest rates indicate they are getting paid for borrowing, which is a very unlikely scenario.

- In my understanding and opinion, it could happen **if the company is in an environment where it is involved in social projects** (Say green projects) and is given a grant or is being fully subsidized by the government on its debt obligations (interest payments) along with this government maybe reimbursing any upside expenses for the projects.
- In rare cases, the cost of debt (Kd) can go negative if we consider the company a **commercial bank**. This can happen during **a severe economic recession** when interest rates have hit their effective lower bound, and people prefer to hold cash rather than make investments or purchases. This situation indicates substantial deflation and a sharp drop in economic activity. Central banks employ a negative interest rate policy, which essentially pays commercial bank's interest on their reserve balances to encourage lending, investment, and spending. As a result, banks are encouraged to lend out, expanding the money supply and boosting the economy.

The **Weighted average cost of capital** represents a company's average cost of capital from all sources, including common stock, preferred stock, bonds, and other forms of debt; Here, it is **9%**. Whether the WACC is higher or lower depends on the sector and industry in which the company operates. Still, generally, a lower value indicates lower capital costs, and a one means higher risk and higher return expectations by investors.
Overall, the company is leveraged, and we can say it is in a high-risk position. Considering the cost of equity, the company is expected to offer high returns to investors and shareholders as compensation for the risk they took in investing.