

## 12<sup>th</sup> WEEK ASSIGNMENT.

Why does the  $\Delta$  EBIT fall as the firm takes more debt

$\Rightarrow$  Increased interest Expenses Higher debt levels lead to higher interest payments, reducing EBIT.

$\Rightarrow$  Higher default risk Excessive debt increases default risk reducing investors confidence default potentially lowering sales/revenues.

$\Rightarrow$  Reduced operating efficiency: Debt servicing costs divert resources from operations, potentially decreasing efficiency.

$\Rightarrow$  Increased financial distress costs Higher debt increases financial distress risk

$\Rightarrow$  Moderate debt levels can provide tax benefits, increasing EBIT

$\Rightarrow$  Debt can discipline management to optimize operations