

3 week Assignment.

Cost of Debt:

• General Rule: Debt generally has the following characteristics

⇒ Fixed payment

⇒ Tax deduction

⇒ Loss of control

• Also consequence debt should include.

⇒ Any interest-bearing liability, whether short ^{term} or long term

⇒ Any lease obligation, whether operating or capital.

* Estimating cost of debt:

Estimating cost of debt [It Rated - cost of debt, Credit rating
not Rated - last borrowed
synthetic Rating.

Estimating synthetic ratings.

The rating for a firm can be estimated using the financial characteristics of the firm.

$$\text{Interest Coverage ratio} = \frac{\text{EBIT}}{\text{Interest Expenses.}}$$

COST OF DEBT FORMULA:

$$RF + DS \times (1-t)$$

~~Risk Free Rate~~ + Default Spread $\times (1-t)$

Estimating cost of debt

cost of debt - cost of debt, credit rating

It Rated [Estimating cost of debt]

not Rated [cost of debt - cost of debt, credit rating]

2 Synthetic Rating

Estimating synthetic ratings

The rating for a firm can be estimated

using the firm's financial characteristics