

Assignment - 3.

Test of debt:

General Rules:

- * Fixed payment
- * Tax deduction
- * Loss of control.

Estimation of cost of debt } It rated - cost of debt, credit rating
 not rated } cost borrowed
 synthetic rating

actual rating is = A

Estimating synthetic ratings:

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

* Interest coverage ratio

$$\text{EBIT} / \text{Interest} + \text{expenses}$$

Cost of debt formula:

$$= R_F + D_S (1 - E)$$

* default spread based upon a rating

* return of debt = risk free rate + default spread.

* after tax cost of debt = pre-tax

cost of debt $(1 - \text{tax rate})$.

[Signature]