8th WEEK ASSIGNMENT

Explain each costs and benefits of debt

Costs of Debt

⇒ Interest Payments: Interest payments are are a direct cost of debt, reducing cash flows.

⇒ Default Risk: it increases with high debt levels, damaging creditworthiness and limiting future borrowing

⇒ Reduced flexibility: high debt levels limit a company's ability to respond to new opportunities or challenges.

⇒ Increased Risk: high debt-to equity ratios increase bankruptcy risk, negatively impacting stock prices.

Benefits of Debt:

⇒ Tax Benefits: interest payments are tax -deductible, reducing taxable income

⇒ Low cost of Capital: debt is often cheaper than equity, especially for companies with stable cash flows.

⇒ Increased Leaverage: debt financing can amplify earnings potential

⇒ Risk Management: Damodaran Explains how debt can hedge against business risks such as commodity price fluctuations

To Evaluate debt's costs and benefits

⇒ Estimating the cost of debt
⇒ Calculating the debt - to equity ratio
⇒ Assessing default risk
⇒ Evaluating debt servicing costs
⇒ Considering tax benefits and risk
⇒ management

By applying this framework, companies can make informed decision about debt financing.