

Explain each costs and benefits of debt

cost of debt:

Interest payments: Interest payments are a direct cost of debt, reduce cash flows.

default risk: It increases with high debt levels, damaging credit worth and limiting future borrowing.

Reduced flexibility: High debt levels limited 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 leverage: debt financing can earnings potential.

TO evaluate debt's costs and benefits

- * estimating the cost of debt
- * calculating the debt-to-equity ratio
- * Assessing default risk
- * Evaluating debt financing costs
- * management.