Deaths-R-Us

Deaths-R-Us is struggling with too much debt and a weaker market. It expects a turnaround in a couple of years,
but now must work out the amount of debt it can carry.

Based on last year's performance, management estimates EBIT at 24 m
Discussions with the banks show that in order to avoid violating covenants
a minimum EBIT interest coverage ratio of 2.6 must be maintained
The company expects growth of 3.50% and pays taxes of 32%
Currently US treasurys pay 6.5%
It currently has debt of 150 m of which 30 m comes due next year
What is the company's debt capacity?
What is the company's debt capacity if it must repay 20% of its debt every year?

Estimating borrowing capacity

Given:

EBIT	
Min EBIT int coverage ratio	
Interest capacity	
Interest rate	
Debt capacity	
Available to repay next year	
Revised debt capacity	

EBIT/Cov. ratio

From table

Int Cap./rate

For smaller and riskier firms
If interest coverage ratio is

>	≤	Rating is	Spread is
-100000	0.499999	D	14.00%
0.5	0.799999	C	12.70%
0.8	1.249999	CC	11.50%
1.25	1.499999	CCC	10.00%
1.5	1.999999	B-	8.00%
2	2.499999	B	6.50%
2.5	2.999999	B+	4.75%
3	3.499999	BB	3.50%
3.5	4.499999	BBB	2.25%
4.5	5.999999	A-	2.00%
6	7.499999	A	1.80%
7.5	9.499999	A+	1.50%
9.5	12.5	AA	1.00%
12.5	100000	AAA	0.75%