CREDIT INSTITUTE

More Business, Less Risk

# DEBT CAPACITY


SYN YEW

*Executive Director*

CREDIT BYTES


## 1. CASHFLOW AVAILABLE TO SERVICE DEBT (PAYMENTS)

**USE: EBITDA – Replacement CAPEX**

A gross cash flow measure before tax and interest

**Example:**

Company ABC has **EBITDA of $200** and **depreciation of $100.**

Cash available for debt repayment:

**$200 – $100 = $100/year**

| | | |
|---|---|---|
| Mode | End / Beginning | |
| Present Value | 558.24 | PV |
| Payments | -100 | PMT |
| Future Value | 0 | FV |
| Annual Rate (%) | 6 | Rate |
| Periods | 7 | Periods |
| Compounding | Annually | |

* **COMPOUNDING**

Ensure that this setting is set to compounding **Annually**.

## 5. DEBT CAPACITY (PV)

Debt capacity is the maximum amount of debt a company can take on and repay over time assuming no growth.

**Debt Capacity ≈ PV of Future Cash Flows to Service and Repay Debt**

## 2. TERMINAL VALUE (FV)

In debt capacity analysis, Future Value is usually set to **zero**. This is because banks focus on full repayment within the forecast period.

## 3. DISC/INTEREST RATES

Prevailing fixed-rate borrowing cost (e.g., 5–7%)

For this case we set the rate at **6%**

## 4. PERIODS

We assume a **7-year loan tenure**, aligning with standard forecast periods where full repayment is expected.

# RESOURCES AND INFORMATION

**ANDROID CALCULATOR**

**APPLE CALCULATOR**

**WEB CALCULATOR**

**TWO TYPICAL APPROACHES TO CALCULATE:**

**1. EBITDA – REPLACEMENT CAPEX**

- A gross cash flow measure before tax and interest
- Simple and frequently used by lenders

**2. EBIT × (1 – T) + DEPRECIATION – REPLACEMENT CAPEX**

- Reflects after-tax, unlevered free cash flow
- More precise but requires tax adjustments

## REPLACEMENT CAPEX:

Minimum capital spending needed to maintain debt servicing cashflow.

~~**annual depreciation charge.**

**DISCOUNT RATE:**

| Cash Flow Method | Discount Rate |
|---|---|
| EBITDA – Replacement Capex | Prevailing fixed-rate borrowing cost (e.g., 5–7%) |
| EBIT(1–t) + Depreciation – Capex | Same borrowing rate, but tax-adjusted: borrowing cost × (1 – tax rate) |

**EXAMPLE:**

Borrowing rate = 6%,
Tax rate = 17%

Tax-adjusted
discount rate = 6% × (1 – 0.17) = 4.98%