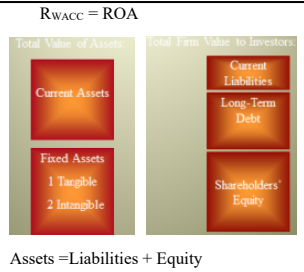


In all equity firm $R_0 = R_{WACC} = R_S$

$R_{WACC} = ROA$

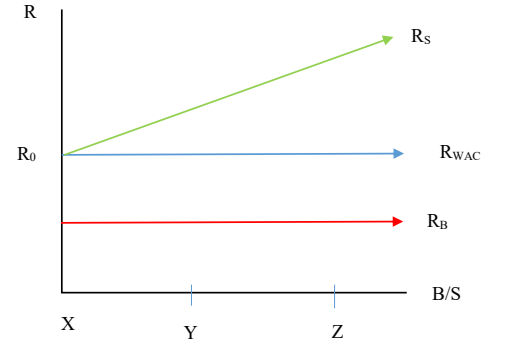


University of Valencia, GIB, Year 2
Prof. Irene Comeig

$\uparrow \frac{B}{S} \rightarrow \uparrow$ Financial Risk $\rightarrow \uparrow R_S$

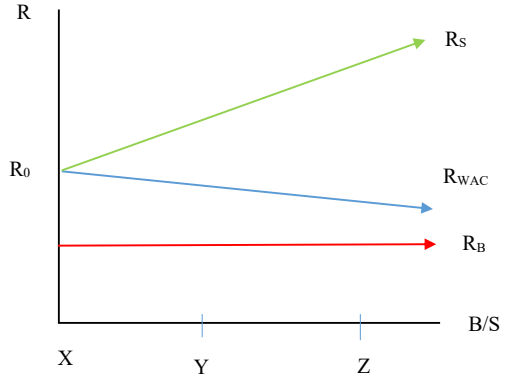
If no taxes \rightarrow

- R_{WACC} does not change = $\frac{R_B B + R_S S}{B + S}$
- V doesn't change with $\frac{B}{S}$
- $NPV = -\text{Initial investment} + \sum_{i=1}^n \frac{NCF_i}{(1 + R_{WACC})^i}$ does not change with B/S



If corporate taxes \rightarrow

- Tax subsidy on debt interests \rightarrow
- $R_{WACC} = \frac{R_B (1-t)B + R_S S}{B + S} = \frac{S}{S+B} R_S + \frac{B}{S+B} R_B (1-t)$
- $V \rightarrow \uparrow$ APV (See Problems 3, 4 and 5)



- \uparrow Cost of financial distress
- \uparrow Probability of not fulfilling payment obligations on time
- \rightarrow Cost of financial distress tends to offset the advantages of debt
- \rightarrow The optimal debt/equity is: some, in order to reduce corporate tax, but not too much.

