

Module 4 – (ch12) Estimating Cost of Capital

Henrique C. Martins - henrique.martins@fgv.br

Note: This summary will be delivered **in printed form only**. No PDF version is available.

Overview: This summary covers the key points from Ch. 12 of *Berk & DeMarzo*.

1) **Equity Cost of Capital (CAPM / SML)**

$$R_i = R_f + \beta(E[R_M] - R_f).$$

Only market risk matters; firm-specific risk is diversifiable.

2) **Market Portfolio & Premium**

Value-weighted portfolio; common proxies (S&P 500, Ibov).

Rf rate choices. Risk premium can be historical or implied (dividend yield + growth).

3) **Beta Estimation**

From regression on excess returns. Industry betas reduce error; debt betas are small.

4) **Debt Cost of Capital**

Expected return \approx YTM – (default rate \times loss rate).

Can also apply CAPM with debt beta.

5) **Project Cost of Capital**

Use comparables; unlever to get asset beta/cost. Adjust for cash and division risk.

6) **WACC**

$$\text{Pre-tax: } R_u = \frac{E}{D+E}R_e + \frac{D}{D+E}R_d. \text{ After-tax: } R_{wacc} = \frac{E}{D+E}R_e + \frac{D}{D+E}R_d(1 - \phi_c).$$

Scan to Access Online Class Resources



Slides



T/F



Numeric



MCQ



Long-form

Notes