Introduction

Using a Modigliani Miller world to simplify the exposition, we cover three complementary valuation approaches:

1. The Adjusted Present Value (APV) approach
2. The Flows to Equity (FTE) approach
3. The Weighted Average Cost of Capital (WACC) approach

The first approach, referred to as the adjusted present value approach, or APV, values the financing cash flows separately from the operating cash flows of the project. The second approach, the flows to equity approach, or FTE, values only the cash flows available to the common stockholders. The present value of these cash flows is reduced by the common equity part of the initial investment to get the NPV. The third approach, the weighted average cost of capital approach, or WACC, discounts unlevered cash flows by the WACC. The interest tax shield is incorporated into the NPV analysis through the WACC.