Overview

This unit incorporates materials covered previously in Finance 531 and 581. Chapter 6 of the assigned textbook covers capital budgeting for an all equity firm. Chapters 11 and 13 introduce asset-pricing models and costs of capital that can be applied to determine the appropriate discount rate given the risk of a project. You are expected to have completed the materials posted on the SELF REVIEW module that assist your review of related topics. Chapter 18 ties major topics together by incorporating the effects of financial leverage into capital budgeting. In other words, Chapter 18 is about the integration of financing (capital structure) decision and investment (capital budgeting) decision.

Learning Objectives

Upon completion of this unit, students are expected to be able to:

- Explain the effects of financial leverage on the value created by a project.
- **Apply the adjusted present value (APV), flow to equity (FTE), and weighted average cost of capital (WACC) approaches to value projects with financial leverage, and perform the related calculations.**
- Explain when the APV approach to calculating project value is more appropriate than the FTE or WACC approaches.
- Explain the conceptual differences between the APV, FTE, and WACC approaches.
- Estimate/Calculate the cost of capital (and the beta) using the **Pure-Play Method**.
- Explain the difference between the asset beta and equity beta for a levered firm, and calculate the equity beta from the asset beta, given the debt ratio and the corporate tax rate.