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The Hamada Equation Reconsidered

21 Pages

Posted: 25 Mar 2014

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Date Written: March 23, 2014

Abstract

A relationship between levered β and unlevered β that is consistent with the Miller-Modigliani Theorem (MM) is presented as a Modified Hamada Equation (MHE). It differs from the Original Hamada Equation (OHE). A scenario analysis reveals that the OHE results are anomalous when the firm's cost of debt is not equal to the risk-free rate and when its operating returns are different from market returns. The MHE is proposed as a more stable and reliable alternative

Keywords: Hamada, levered beta, financial leverage, WACC, CAPM, capital asset pricing model, Miller-Modigliani, capital structure, optimal capital structure, cost of capital, effect of debt on beta, numerical methods

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