A More Realistic Valuation: APV and WACC with Constant Book Leverage Ratio

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Abstract

We value a company that targets its capital structure in book - value terms. This capital structure definition provides us with a valuation that lies between those of Modigliani - Miller (fixed debt) and Miles - Ezzell (fixed market - value leverage ratio).

We show that if a company targets its leverage in market - value terms, it has less value than if it targets the leverage in book - value terms. We also present empirical evidence that permits us to conclude that debt is more related to the book - value of the assets than to their market - value.

Keywords: value of tax shields, required return to equity, WACC, company valuation, APV, cost of equity

JEL Classification: G12, G31, G32

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