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Weighted average cost of capital in the theory of Modigliani–Miller, modified for a finite lifetime company

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Abstract

The theory of Modigliani–Miller (MM) is based on the assumption that the accounting value of a company is equal to the sum of its assets. While the accounting value of a company is much less than its market value, the theory of MM is not applicable to the first case. We have solved the obtained equation for a 2 year company and compared this result with those

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of Myers and MM. It shows that WACC values for 2 year company is closer to MM (perpetuity) limit than to Myers (1 year) one at small equity cost (just above the debt cost) while at bigger equity cost, it is closer to Myers limit than to MM one. Algorithm for finding of WACC in the case of arbitrary lifetime of the project has been developed. The use of the obtained equations for the projects of n years, and for companies operating in the market n years significantly alters the assessment of the WACC of the company.

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