Corporate Finance, Module 17

Homework Assignment

(The attached PDF file has better formatting.)

A project with an indefinite life has an initial investment of $10 million.

The opportunity cost of capital is 12% with all-equity financing, the borrowing rate is 8%, and the firm borrows $4 million against the project.

- ! The debt is perpetual; it is refinanced each year.
- ! The corporate tax rate is 35%.

A. What is the interest paid in each year?
B. What is the present value of the debt tax shields if the debt is fixed at $4 million?
C. If the debt is re-balanced each year to a fixed percentage of the project's value, is the present value of the debt tax shield higher or lower? Explain why.

For *Part C,* see page 537 of the textbook (14th edition).