WACC

The rate a firm must earn to satisfy its funders.

Accounting & Finance

The weighted average cost of capital blends the after-tax cost of debt with the cost of equity.

$$WACC = (E/V)Re + (D/V)Rd(1 - t)$$

Debt is cheaper	**Lower risk, and tax deductible**
More debt Offsets the gain.	**Equity gets riskier**
Use as	**Discount rate for average-risk projects**

THE COMMON MISTAKE

× Using WACC for every project

✓ Adjusting for project risk

WACC reflects the firm's existing risk. A riskier project discounted at WACC will look better than it is.

The tax shield is why debt appears cheap. Interest reduces taxable profit; dividends do not.