**Case Solutions**

***Corporate Finance***

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**11thedition**

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***CHAPTER2***

**CASH FLOWS AT WARF COMPUTERS**

The operating cash flow for the company is: (NOTE: All numbers are in thousands of dollars)

OCF = EBIT + Depreciation – Current taxes

OCF = $2,080 + 248 – 605

OCF = $1,723

To calculate the cash flow from assets, we need to find the capital spending and change in net working capital. The capital spending for the year was:

|  |  |  |
| --- | --- | --- |
|  | *Capital spending* |  |
|  | Ending net fixed assets | $3,601 |
|  | – Beginning net fixed assets | 2,796 |
|  | + Depreciation | 248 |
|  | Net capital spending | $1,053 |

And the change in net working capital was:

|  |  |  |
| --- | --- | --- |
|  | *Change in net working capital* | |
|  | Ending NWC | $1,135 |
|  | – Beginning NWC | 914 |
|  | Change in NWC | $221 |

So, the cash flow from assets was:

|  |  |  |
| --- | --- | --- |
|  | *Cash flow from assets* |  |
|  | Operating cash flow | $1,723 |
|  | – Net capital spending | 1,053 |
|  | – Change in NWC | 221 |
|  | Cash flow from assets | $449 |

The cash flow to creditors was:

|  |  |  |
| --- | --- | --- |
|  | *Cash flow to creditors* |  |
|  | Interest paid | $137 |
|  | – Net New Borrowing | 31 |
|  | Cash flow to Creditors | $106 |

The cash flow to stockholders was:

|  |  |  |
| --- | --- | --- |
|  | *Cash flow to stockholders* |  |
|  | Dividends paid | $292 |
|  | – Net new equity raised | – (–51) |
|  | Cash flow to Stockholders | $343 |

The accounting cash flow statement of cash flows for the year was:

|  |  |  |
| --- | --- | --- |
|  | Statement of Cash Flows | |
|  | Operations |  |
|  | Net income | $1,167 |
|  | Depreciation | 248 |
|  | Deferred taxes | 171 |
|  | Changes in assets and liabilities |  |
|  | Accounts receivable | (48) |
|  | Inventories | 22 |
|  | Accounts payable | 34 |
|  | Accrued expenses | (154) |
|  | Other | (14) |
|  | Total cash flow from operations | $1,426 |
|  |  |  |
|  | Investing activities |  |
|  | Acquisition of fixed assets | $(1,482) |
|  | Sale of fixed assets | 429 |
|  | Total cash flow from investing activities | $(1,053) |
|  |  |  |
|  | Financing activities |  |
|  | Retirement of debt | $(197) |
|  | Proceeds of long-term debt | 228 |
|  | Dividends | (292) |
|  | Repurchase of stock | (66) |
|  | Proceeds from new stock issues | 15 |
|  | Total cash flow from financing activities | $(312) |
|  |  |  |
|  | Change in cash (on balance sheet) | $61 |

*Answers to questions*

**1.** The firm had positive earnings in an accounting sense (NI > 0) and had positive cash flow from operations and a positive cash flow from assets. The firm invested $221 in new net working capital and $1,053in new fixed assets. The firm was able to return $343 to its stockholders and $106 to creditors.

**2.** The financial cash flows present a more accurate picture of the company since it accurately reflects interest cash flows as a financing decision rather than an operating decision.

**3.** The expansion plans look like they are probably a good idea. The company was able to return a significant amount of cash to its shareholders during the year, but a better use of these cash flows may have been to retain them for the expansion. This decision will be discussed in more detail later in the book.