**Case Solutions**

***Corporate Finance***

**Ross, Westerfield, Jaffe, and Jordan**

**12th edition**

**01/02/2019**

**Prepared by:**

**Brad Jordan**

**University of Kentucky**

**Joe Smolira**

**Belmont University**

***CHAPTER 2***

**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 = $2,665 + 298 – 559

OCF = $2,404

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 | $4,322 |
|  | – Beginning net fixed assets | 3,356 |
|  | + Depreciation | 298 |
|  | Net capital spending | $1,264 |

And the change in net working capital was:

|  |  |  |
| --- | --- | --- |
|  | *Change in net working capital* | |
|  | Ending NWC | $1,361 |
|  | – Beginning NWC | 1,097 |
|  | Change in NWC | $264 |

So, the cash flow from assets was:

|  |  |  |
| --- | --- | --- |
|  | *Cash flow from assets* |  |
|  | Operating cash flow | $2,404 |
|  | – Net capital spending | 1,264 |
|  | – Change in NWC | 264 |
|  | Cash flow from assets | $876 |

The cash flow to creditors was:

|  |  |  |
| --- | --- | --- |
|  | *Cash flow to creditors* |  |
|  | Interest paid | $164 |
|  | – Net New Borrowing | 36 |
|  | Cash flow to Creditors | $128 |

The cash flow to stockholders was:

|  |  |  |
| --- | --- | --- |
|  | *Cash flow to stockholders* |  |
|  | Dividends paid | $688 |
|  | – Net new equity raised | – 60 |
|  | Cash flow to Stockholders | $748 |

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

|  |  |  |
| --- | --- | --- |
|  | Statement of Cash Flows | |
|  | Operations |  |
|  | Net income | $1,876 |
|  | Depreciation | 298 |
|  | Deferred taxes | 66 |
|  | Changes in assets and liabilities |  |
|  | Accounts receivable | –57 |
|  | Inventories | 26 |
|  | Accounts payable | 41 |
|  | Accrued expenses | –185 |
|  | Other | –16 |
|  | Total cash flow from operations | $2,049 |
|  |  |  |
|  | Investing activities |  |
|  | Acquisition of fixed assets | –$1,778 |
|  | Sale of fixed assets | 514 |
|  | Total cash flow from investing activities | –$1,264 |
|  |  |  |
|  | Financing activities |  |
|  | Retirement of debt | –$238 |
|  | Proceeds of long-term debt | 274 |
|  | Dividends | –688 |
|  | Repurchase of stock | –79 |
|  | Proceeds from new stock issues | 19 |
|  | Total cash flow from financing activities | –$712 |
|  |  |  |
|  | Change in cash (on balance sheet) | $73 |

*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 $264 in new net working capital and $1,264 in new fixed assets. The firm was able to return $748 to its stockholders and $128 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.