**Case Solutions**

***Corporate Finance: Core Principles and Applications***

**3rd edition**

***CHAPTER 1***

**EAST COAST YACHTS**

**1.** A LLC (limited liability company) is essentially a form of a partnership (or sole proprietorship) and a corporation. The goal is to operate like a partnership or sole proprietorship, but have limited liability for the owner(s). The advantages to a LLC are: 1) Reduction of personal liability. A sole proprietor has unlimited liability, which can include the potential loss of all personal assets. 2) Taxes. Forming an LLC may mean that more expenses can be considered business expenses and be deducted from the company’s income. 3) Improved credibility. The business may have increased credibility in the business world compared to a sole proprietorship 4) Ability to attract investment. Corporations, even LLCs, can raise capital through the sale of equity. 5) Continuous life. Sole proprietorships have a limited life, while corporations have a potentially perpetual life. 6) Transfer of ownership. It is easier to transfer ownership in a corporation through the sale of stock. 7) Potential for reduced agency problems compared to a corporation.

The biggest disadvantage is the potential cost, although the cost of forming a LLC can be relatively small. Another potential disadvantage is double taxation, which applies to corporations and LLCs, but can be avoided for the LLC if certain specific criteria are met. There are also other potential costs, including more expansive record-keeping.

**2.** Forming a corporation has the same advantages as forming a LLC, but the costs are likely to be higher.

**3.** As a small company, changing to a LLC is probably the most advantageous decision at the current time. If the company grows, and Larissa is willing to sell equity ownership, the company can reorganize as a corporation at a later date. Additionally, forming a LLC is likely to be less expensive than forming a corporation.

***CHAPTER 2***

**CASH FLOWS AT EAST COAST YACHTS**

**Cash Flow Identity**

The operating cash flow for the company is:

OCF = EBIT + Depreciation – Current taxes

OCF = $88,416,000 + 20,160,000 – 30,921,600

OCF = $77,654,400

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 | $353,874,000 |
|  | – Beginning net fixed assets | 320,820,000 |
|  | + Depreciation | 20,160,000 |
|  | Net capital spending | $53,214,000 |

And the change in net working capital was:

|  |  |  |
| --- | --- | --- |
|  | *Change in net working capital* | |
|  | Ending NWC | $5,824,000 |
|  | – Beginning NWC | –1,153,440 |
|  | Change in NWC | $6,977,440 |

So, the cash flow from assets was:

|  |  |  |
| --- | --- | --- |
|  | *Cash flow from assets* |  |
|  | Operating cash flow | $77,654,400 |
|  | – Net capital spending | 53,214,000 |
|  | – Change in NWC | 6,977,440 |
|  | Cash flow from assets | $17,462,960 |

The cash flow to creditors was:

|  |  |  |
| --- | --- | --- |
|  | *Cash flow to creditors* |  |
|  | Interest paid | $11,112,000 |
|  | – Net new borrowing | –17,200,000 |
|  | Cash flow to creditors | –$6,088,000 |

The cash flow to stockholders was:

|  |  |  |
| --- | --- | --- |
|  | *Cash flow to stockholders* |  |
|  | Dividends paid | $17,550,960 |
|  | – Net new equity raised | –6,000,000 |
|  | Cash flow to stockholders | $23,550,960 |

And the cash flow identity was:

Cash flow from assets = Cash flow to creditors + Cash flow to stockholders

$17,462,960 = –$6,088,000 + 23,550,960

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

|  |  |  |
| --- | --- | --- |
|  | Accounting Statement of Cash Flows | |
|  | Operations |  |
|  | Net income | $46,382,400 |
|  | Depreciation | 20,160,000 |
|  | Changes in assets and liabilities |  |
|  | Accounts receivable | (1,092,000) |
|  | Inventories | (5,392,800) |
|  | Accounts payable | 844,560 |
|  | Accrued expenses | 713,000 |
|  | Other | (75,200) |
|  | Total cash flow from operations | $61,539,960 |
|  |  |  |
|  | Investing activities |  |
|  | Acquisition of fixed assets | $(60,000,000) |
|  | Sale of fixed assets | 6,786,000 |
|  | Total cash flow from investing activities | $(53,214,000) |
|  |  |  |
|  | Financing activities |  |
|  | Retirement of debt | $(22,800,000) |
|  | Proceeds of long-term debt | 40,000,000 |
|  | Notes payable | (1,495,000) |
|  | Dividends | (17,550,960) |
|  | Repurchase of stock | (36,000,000) |
|  | Proceeds from new stock issues | 30,000,000 |
|  | Total cash flow from financing activities | $(7,845,960) |
|  |  |  |
|  | Change in cash (on balance sheet) | $480,000 |

*Answers to questions*

**1.** The firm had positive earnings in an accounting sense (NI > 0) and had positive cash flow from operations. The firm invested $6,977,440 in new net working capital and $53,214,000 in new fixed assets. The firm was able to return $6,088,000 to its creditors, but received $23,550,960 from stockholders.

**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 since the company appears to have a fairly strong operating cash flow, although the company already invested a significant amount in fixed assets during the past year. This decision will be discussed in more detail later in the book.