**Case Solutions**

***Essentials of Corporate Finance***

**Ross, Westerfield, and Jordan**

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**CHAPTER 1**

***THE McGEE CAKE COMPANY***

**1.** 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.

The biggest disadvantage is the potential cost, although the cost of forming a LLC can be relatively small. 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 Doc and Lyn are willing to sell more 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 AND FINANCIAL STATEMENTS AT SUNSET BOARDS***

Below are the financial statements that you are asked to prepare.

**1.** The income statement for each year will look like this:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | *Income statement* | | | |
|  |  | *2009* |  | *2010* |
|  | Sales | $277,855 |  | $338,688 |
|  | Cost of goods sold | 141,641 |  | 178,839 |
|  | Selling & administrative | 27,854 |  | 36,355 |
|  | Depreciation | 39,983 |  | 45,192 |
|  | EBIT | $68,377 |  | $78,302 |
|  | Interest | 8,702 |  | 9,962 |
|  | EBT | $59,675 |  | $68,340 |
|  | Taxes | 11,935 |  | 13,668 |
|  | Net income | $47,740 |  | $54,672 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | Dividends | $23,870 |  | $27,336 |
|  | Addition to retained earnings | 23,870 |  | 27,336 |

**2.** The balance sheet for each year will be:

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | *Balance sheet as of Dec. 31, 2009* | | | | | |
|  | Cash | $20,437 |  |  | Accounts payable | $36,120 |
|  | Accounts receivable | 14,482 |  |  | Notes payable | 16,464 |
|  | Inventory | 30,475 |  |  | Current liabilities | $52,584 |
|  | Current assets | $65,394 |  |  |  |  |
|  |  |  |  |  | Long-term debt | $89,040 |
|  | Net fixed assets | $176,400 |  |  | Owners' equity | $100,170 |
|  | Total assets | $241,794 |  |  | Total liab. & equity | $241,794 |

In the first year, equity is not given. Therefore, we must calculate equity as a plug variable. Since total liabilities & equity is equal to total assets, equity can be calculated as:

Equity = $241,794 – 89,040 – 52,854

Equity = $100,170

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | *Balance sheet as of Dec. 31, 2010* | | | | | |
|  | Cash | $30,880 |  |  | Accounts payable | $40,908 |
|  | Accounts receivable | 18,785 |  |  | Notes payable | 17,976 |
|  | Inventory | 41,821 |  |  | Current liabilities | $58,884 |
|  | Current assets | $91,486 |  |  |  |  |
|  |  |  |  |  | Long-term debt | $102,480 |
|  | Net fixed assets | $214,184 |  |  | Owners' equity | $144,306 |
|  | Total assets | $305,670 |  |  | Total liab. & equity | $305,670 |

The owner’s equity for 2010 is the beginning of year owner’s equity, plus the addition to retained earnings, plus the new equity, so:

Equity = $100,170 + 27,336 + 16,800

Equity = $144,306

**3.** Using the OCF equation:

OCF = EBIT + Depreciation – Taxes

The OCF for each year is:

OCF2009 = $68,377 + 39,983 – 11,935

OCF2009 = $96,425

OCF2010 = $78,302 + 45,192 – 13,668

OCF2010 = $109,826

**4.** 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 | $214,184 |
|  | – Beginning net fixed assets | 176,400 |
|  | + Depreciation | 45,192 |
|  | Net capital spending | $ 82,976 |

And the change in net working capital was:

|  |  |  |
| --- | --- | --- |
|  | *Change in net working capital* | |
|  | Ending NWC | $32,602 |
|  | – Beginning NWC | 12,810 |
|  | Change in NWC | $19,792 |