Analysis for Financial Management 11th edition Higgins Solutions Manual

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Analysis for Financial Management, 11e
SUGGESTED ANSWERS TO EVEN-NUMBERED PROBLEMS

Chapter 1

2. Management is either dumb or thinks its board is. Earning $100 million on a $4 billion equity investment is a return of 2.5 percent, a figure well below any reasonable cost of equity. As a board member, I would vote to cut management's compensation, not raise it. I would also criticize them sharply for apparently attempting to deceive the board.

4. a. Cash rises $500,000; plant and equipment falls $300,000; equity rises $200,000.
   b. Net plant and equipment rises $80 million; Cash falls $32 million; Bank debt rises $48 million.
   c. Net plant and equipment rises $60 million; cash falls $60 million.
   d. Cash falls $40,000; Accounts payable falls $40,000.
   e. Cash falls $240,000; Owners' equity falls by $240,000 (via an increase in treasury stock).
   f. Cash rises $80,000; Inventory falls; Accrued taxes, Owners' equity, and possibly other cost categories rise such that the algebraic sum equals $80,000.
   g. Accounts receivable rise $120,000. Other categories change as described in part f.
   h. Cash falls $50,000. Owners' equity falls by $50,000 (via Retained Earnings).

6. a. **R&E Supplies, Inc.** Sources and Uses Statement 2011–2014 ($000).

Sources of cash:	
Decrease in cash and securities	$259
Increase in accounts payable	2,205
Increase in current portion long-term debt	40
Increase in accrued wages	13
Increase in retained earnings	537
Total	$3,054
Uses of cash:	
Increase in accounts receivable	$1,543
Increase in inventories	1,148
Increase in prepaid expenses	4
Increase in net fixed assets	159
Decrease in long-term debt	200
Total	$3,054

b. Insights:

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i. R&E is making extensive use of trade credit to finance a buildup in current assets. The increase in accounts payable equals almost three fourths of total sources of cash. Increasing accounts receivable and inventories account for almost 90 percent of the uses of cash.

ii. External long-term debt financing is a use of cash for R&E, meaning that it is repaying its loans. A restructuring involving less reliance on accounts payable and more bank debt appears appropriate.

8. Accounting income will be the value of the parcels sold, less their original purchase price. So if all parcels are sold, the income is 5 × $16 million + 5 × $8 million – $100 million = $20 million. Economic income will be the increase in the market value of the land, whether sold or not, over the period. At the end of the first year, this will be $20 million. Answers to each part of the question appear below.

Question	*Accounting Income*	*Economic Income*
a	$20 million	$20 million
b	0	$20 million
c	–$10 million	$20 million
d	$30 million	$20 million

e. Too many companies have tried this. If the market value of a piece of land falls, the owner loses whether he sells or not. The market price of the land fell because people thought the future income stream to the owners was worth less. Continuing to hold the property forces the owner to accept the lower income. Whether the loss is recognized or not might affect accounting earnings, but has nothing to do with reality.

10. The accounting profits from Jonathan's brewery are expected to be $40,000. These accounting profits do not include the implicit cost of the entrepreneur's time. Jonathan's time is worth at least $62,000, the current income he will have to forego to manage the brewery. When these implicit opportunity costs are included net income falls to:

$230,000 – $190,000 – $62,000 = –$22,000

This new venture will reduce Jonathan's income not increase it.

12. a.

Company	*A*	*B*	*C*
End-of-year cash Balance	$150 million	$30 million	$120 million

b. It appears that company C retired more debt than it issued, repurchased more stock than it issued, or some combination of the two.

c. I'd prefer to own company A. A appears to be a growing company as evidenced by the sizable net cash used in investing activities, and its negative net cash flow from operations may well be due to increasing accounts receivable and inventories that naturally accompany sales growth. Company B appears not to be growing, so its negative net cash flows from operations are probably due to losses or to increasing receivables and inventories relative to sales, a trend denoting poor management of current assets.

d. I don't think there is necessarily any cause for concern. It appears company C is a mature, slow-growth company that is returning its unneeded operating cash flows to investors in the form of debt repayment, share repurchase, dividends, or some combination of these. This is a perfectly viable strategy in the absence of attractive investment opportunities.

14. See Excel solutions at **mhhe.com/higgins11e.**