Chapter #2
Solutions to Questions and Problems

1. Owner’s equity = $3,400
   NWC = $1,500

2. Income Statement
   - Sales: $565,000
   - Costs: 240,000
   - Depreciation: 74,000
   - EBIT: $251,000
   - Interest: 41,000
   - Taxable income: $210,000
   - Taxes: 73,500
   - Net income: $136,500

3. Addition to retained earnings = $91,500

4. EPS = $4.55 per share
   DPS = $1.50 per share

5. Current assets = $1,575,000
   - Book value of assets
     Current assets: $1,575,000
     Fixed assets: 2,500,000
     Total assets: $4,075,000
   - Market value of assets
     Current assets: $1,600,000
     Fixed assets: 4,600,000
     Total assets: $6,200,000
6. Taxes = $92,450

7. The Average tax rate = .3302 or 33.02%
   The marginal tax rate is 39 percent.

8. OCF = $7,445

9. Net capital spending = $690,000

11. Cash flow to creditors = –$135,000

14. a. Addition to retained earnings = $18,490
    OCF = $43,590

    b. The Cash flow to creditors = $10,900

    c. The cash flow to stockholders = $5,900

15. Net income = $3,015
    Taxable income = $5,025
    EBIT = $6,545
    Depreciation = $4,455

16. Owners’ equity = $545,000

17. Owners’ equity = Max [(TA – TL), 0 ]

    a. If TA = $6,100:
       Owners’ equity = $800

    b. If TA = $4,600:
       Owners’ equity = $0

18. a. Taxes\text{Growth} = $18,170

    Taxes\text{Income} = $2,992,000

    b. The marginal tax rate is the tax rate on the next $1 of earnings. Each firm has a marginal
tax rate of 34% on the next $10,000 of taxable income, despite their different average tax
rates, so both firms will pay an additional $3,400 in taxes.
19.  

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<thead>
<tr>
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<tbody>
<tr>
<td>Sales</td>
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<tr>
<td>Cost of goods sold</td>
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<tr>
<td>Other expenses</td>
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The taxes are zero since we are ignoring any carryback or carryforward provisions.

b. OCF = $685,000

c. Net income was negative because of the tax deductibility of depreciation and interest expense. However, the actual cash flow from operations was positive because depreciation is a non-cash expense and interest is a financing, not an operating, expense.

21.  

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b. OCF = $3,400

c. Change in NWC = $1,010
   Net capital spending = $2,520