Analysis for Financial Management, 13e
SUGGESTED ANSWERS TO EVEN-NUMBERED PROBLEMS

Chapter 1

2. Management is either foolish or thinks its board is. Earning $100 million on a $5 billion equity investment is a return of 2 percent, which is 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 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 2018–2021 ($ thousands)

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:

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 Desmond's brewery are expected to be $60,000. These accounting profits do not include the implicit cost of the entrepreneur's time. Desmond's time is worth at least $70,000, the current income he will have to forego to manage the brewery. When these implicit opportunity costs are included income falls to:

$$\$250{,}000 - \$190{,}000 - \$70{,}000 = -\$10{,}000$$

This new venture will clearly reduce Desmond'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 suggested solutions to Excel problems at McGraw-Hill's *Connect* or at www.mhhe.com/Higgins13e.

Robert C. Higgins, Jennifer L. Koski, Todd Mitton
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Recommended Cases to Accompany *Analysis for Financial Management*, 13e

This note offers chapter-by-chapter recommendations of cases that work well with *Analysis for Financial Management*, tips on finding other quality cases, and advice on preparing course packets.

As you review these recommendations, keep in mind that cases can be quite personal, so that what works well for one instructor may not work for others. Be prepared, then, for some trial-and-error as you search for cases that meet your needs. Remember too that the cases I am about to mention are from a necessarily short list that I have used successfully in the past, or intend to use in the near future. I am sure there are many other highly effective cases of which I am unaware. Indeed, if you spot any glaring omissions in my recommended list, please let me know.

The Principal Case Collections

Here are the web addresses of the principal case collections. Access to these sites is restricted to registered users, but registration is a simple process for bonafide instructors. All of the sites offer searches, and full-text copies of many cases are available as pdf files. Teaching notes are also often available on request.

- https://hbsp.harvard.edu/. Harvard Business School is the major provider of business cases. This site offers abstracts of Harvard cases and full-text copies of most. The site also contains cases prepared by faculty at other schools including Babson, Northwestern, Stanford, Ivey and Darden.

- https://store.darden.virginia.edu/. The Darden Graduate School of Business at the University of Virginia is second only to Harvard as a source of business cases. Importantly, the site provides access to cases written by Bob Bruner, Ken Eades, and Michael Schill, three of the best finance case writers working today.

- https://www.iveycases.com/. The Richard Ivey School of Business at the University of Western Ontario is producing a number of finance cases with particular strength in entrepreneurial finance and Asian finance.

- www.ecchatbabson.org. The European Case Clearing House is a consortium of primarily European universities that offers access to business cases with emphasis on international management. Consortium members include IMD, INSEAD, and Cranfield University.

Recommended Cases (Roughly in order of increasing difficulty.)

Most recommended cases come with teaching notes, and many provide Excel spreadsheets of case exhibits. Almost all of these cases are available through the Harvard Business School case website listed above (although the case numbers, in particular for the Darden cases, differ).

Chapters 1 and 2 Interpreting Financial Statements and Evaluating Financial Performance

1. Case of the Unidentified Industries - 2018

Source:	Harvard
Case Number:	9-219-046
Length:	2 pages
Year:	2018

The case contains common-size balance sheets and financial ratios for 14 companies, each representative of a different industry. The challenge is to identify the industries from the structure of the financial statements. This very short case can be distributed and discussed in the same class, excellent for the first day of class.

2. The Financial Detective, 2016

Source:	Darden
Case Number:	UV7201
Length:	4 pages
Year:	2016

Similar to the Case of the Unidentified Industries, this case asks students to match eight sets of financial ratios with eight company descriptions. For each industry, financial ratios are presented for two different companies, allowing students to compare ratios within an industry as well as across industries. A great alternative for the first day of class.

3. Anandam Manufacturing Company: Analysis of Financial Statements

Source:	Ivey
Case Number:	W16204
Length:	6 pages
Year:	2016

Management at Anandam has approached a bank to obtain additional funding to meet the growing requirements of this garment manufacturing firm. Students must prepare common sized financial statements and interpret ratios provided in the case to assess the financial health of the company. This case is a good early case for students learning to evaluate financial statements.

4. Sears, Roebuck and Co. and Wal-Mart Stores, Inc.

Source:	Harvard
Case Number:	9-101-011
Length:	18 pages
Year:	2006

Sears and Wal-Mart have very similar returns on equity in 1997. The challenge is to understand how each company generated its ROE and to decide which of the two has better performance.

List of Files