CHAPTER 2
CASH FLOWS AT WARF COMPUTERS

The operating cash flow for the company is: (NOTE: All numbers are in thousands of dollars)

OCF = EBIT + Depreciation – Current taxes
OCF = $2,665 + 298 – 559
OCF = $2,404

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	$4,322
– Beginning net fixed assets	3,356
+ Depreciation	298
Net capital spending	$1,264

And the change in net working capital was:

Change in net working capital	
Ending NWC	$1,361
– Beginning NWC	1,097
Change in NWC	$264

So, the cash flow from assets was:

Cash flow from assets	
Operating cash flow	$2,404
– Net capital spending	1,264
– Change in NWC	264
Cash flow from assets	$876

The cash flow to creditors was:

Cash flow to creditors	
Interest paid	$164
– Net New Borrowing	36
Cash flow to Creditors	$128

The cash flow to stockholders was:

Cash flow to stockholders	
Dividends paid	$688
– Net new equity raised	– 60
Cash flow to Stockholders	$748

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

Statement of Cash Flows

Operations	
Net income	$1,876
Depreciation	298
Deferred taxes	66
Changes in assets and liabilities	
Accounts receivable	–57
Inventories	26
Accounts payable	41
Accrued expenses	–185
Other	–16
Total cash flow from operations	$2,049
Investing activities	
Acquisition of fixed assets	–$1,778
Sale of fixed assets	514
Total cash flow from investing activities	–$1,264
Financing activities	
Retirement of debt	–$238
Proceeds of long-term debt	274
Dividends	–688
Repurchase of stock	–79
Proceeds from new stock issues	19
Total cash flow from financing activities	–$712
Change in cash (on balance sheet)	$73

Answers to questions

1. The firm had positive earnings in an accounting sense (NI > 0) and had positive cash flow from operations and a positive cash flow from assets. The firm invested $264 in new net working capital and $1,264 in new fixed assets. The firm was able to return $748 to its stockholders and $128 to creditors.

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. The company was able to return a significant amount of cash to its shareholders during the year, but a better use of these cash flows may have been to retain them for the expansion. This decision will be discussed in more detail later in the book.