Session 3: Post class test solutions

1. **d. A one-time charge to cover a lawsuit settlement**. Even though it is a one-time expense and may be classified as extraordinary, it is an actual cash expense (since the settlement has to be paid).
2. **a. Investment in marketable securities (treasury bills and commercial paper**) Non-financial service companies invest excess cash into marketable securities. It is not reinvestment into operating businesses and should not be subtracted out for cash flows.
3. **Effects**
    a. Increase in inventory: Ties up cash and reduces cash flow
    b. Increase in accounts payable: Frees up cash and increases cash flow
    c. Increase in accounts receivable: Ties up cash and reduces cash flow
    d. Increase in taxes due: Frees up cash and increases cash flow
    e. Increase in cash balance: No effect. It is where the net cash flow shows up.
4. **d.** Low capital expenditures, high depreciation, decreasing working capital. The high depreciation and the decrease in working capital both push up cash flows, and since the cap ex is lower than depreciation, cashflows will exceed earnings.
5. **b. Young, growth companies, just starting to turn profitable and with high growth potential.** The growth rate in income will be high, but the reinvestment needed to deliver future growth will generally outweigh the profit effect, causing cash flows to become more negative (at least initially before they turn positive.