

1. *International Business Machines Corporation* (IBM), the world's largest computer manufacturer, on Tuesday, January 19, 1988, reported greatly increased earnings for the fourth quarter of 1987. In spite of this reported gain in earnings, the price of IBM's stock on the New York Stock Exchange declined by \$6 per share to \$111.75. In sympathy with this move, most other technology stocks also declined.

Fourth-quarter net earnings rose from \$1.39 billion, or \$2.28 a share, to \$2.08 billion, or \$3.47 a share, an increase of 49.6 percent and 52.2 percent over the year-earlier period. Management declared that these results demonstrated the effectiveness of IBM's efforts to become more competitive, and that, in spite of the economic uncertainties of 1988, the company was planning for growth.

The stock price declined, however, apparently because the huge increase in income was the result of nonrecurring gains. Investment analysts pointed out that IBM's high earnings stemmed primarily from elements such as a lower tax rate. Despite most analysts' expectations of a tax rate between 40 and 42 percent, IBM's rate was down from the previous year's 45.3 percent to a low 36.4 percent.

In addition, analysts were disappointed in the revenue growth. Revenues within the United States were down, and much of the growth in revenues came through favorable currency translations, increases that may not be repeated. In fact, some estimates of the fourth-quarter earnings attributed \$.50 per share to currency translations and another \$.25 to tax rate changes.

Other factors contributing to the rise in earnings were one-time transactions such as the sale of Intel Corporation stock and bond redemptions, which, along with a corporate stock buyback program, reduced the amount of stock outstanding in the fourth quarter by 7.4 million shares.

Instructions:

The analysts are concerned about the quality of IBM's earnings.

1. Identify four quality of earnings issues reported in the case and explain the analysts concern about each. (10%)
2. In percentage terms, what is the impact of the currency changes on fourth-quarter earnings? (10%)
3. Comment on management's assessment of IBM's performance. Do you agree with management? (10%)

(背面仍有題目,請繼續作答)

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2. (SCF Theory and Analysis of Improper SCF) Catherine Howard and Henry Darnley are examining the following statement of cash flows for Agincourt's Clothing Store's first year of operations.

Agincourt's Clothing Store
STATEMENT OF CASH FLOWS
For the Year Ended January 31, 1996

Sources of cash	
From sales of merchandise	\$362,000
From sale of capital stock	440,000
From sale of investment	80,000
From depreciation	70,000
From issuance of note for truck	30,000
From interest on investments	8,000
Total sources of cash	<u>990,000</u>
Uses of cash	
For purchase of fixtures and equipment	340,000
For merchandise purchased for resale	253,000
For operating expenses (including depreciation)	160,000
For purchase of investment	85,000
For purchase of truck by issuance of note	30,000
For purchase of treasury stock	10,000
For interest on note	3,000
Total uses of cash	<u>881,000</u>
Net increase in cash	<u>\$109,000</u>

Catherine claims that Agincourt's statement of cash flows is an excellent portrayal of a superb first year with cash increasing \$109,000. Henry replies that it was not a superb first year, that the year was an operating failure, that the statement was incorrectly presented, and that \$109,000 is not the actual increase in cash.

Instructions

- (a) With whom do you agree, Catherine or Henry? Explain your position. (10%)
- (b) Using the data provided, prepare a statement of cash flows in proper indirect method form. The only noncash items in income are depreciation and the loss from the sale of the investment (purchase and sale are related). (20%)

3. American Airlines and U.S. Air Excerpts from the December 31, 1992, balance sheets of AMR Corporation (the parent company of American Airlines) and USAir Group, Inc., (the parent company of U.S. Air) regarding their respective lease obligations are as follows:

(all amounts in millions)	American	U.S. Air
Assets:		
Owned property, plant, and equipment	\$11,084	\$6,241
Less: Accumulated depreciation	(2,768)	(1,252)
Net	<u>\$ 8,316</u>	<u>\$4,989</u>
Property, plant, and equipment acquired through capitalized leases	\$ 2,459	\$ 322
Less: Accumulated amortization	(644)	(209)
Net	<u>\$ 1,815</u>	<u>\$ 113</u>
Liabilities:		
Current obligation, capital leases	\$ 99	(not disclosed)
Long-term obligation, capital leases	2,195	(not disclosed)
Total capital lease obligation	<u>\$ 2,294</u>	<u>\$ 137</u>
Total stockholders' equity	<u>\$ 3,349</u>	<u>\$ 44</u>
Total Assets	<u>\$18,706</u>	<u>\$6,595</u>

The notes to the financial statements provide the following additional disclosures regarding capital and operating leases:

AMR Corporation

The future minimum lease payments required under capital leases (together with the present value of net minimum lease payments) and future minimum lease payments required under operating leases that have an initial or remaining noncancelable lease term in excess of one year as of December 31, 1992, were as follows (in millions):

Year Ending December 31	Capital Leases	Operating Leases
1993	\$ 268	\$ 932
1994	267	864
1995	280	837
1996	264	819
1997	248	797
1998 and subsequent	<u>2,629</u>	<u>15,592</u>
	3,956 (a)	<u>\$19,841</u> (a)(b)
Less amount representing interest	<u>1,662</u>	
Present value of net minimum lease payments	<u>\$2,294</u> (c)	

(a) Future minimum payments required under capital leases and operating leases include \$396 million and \$6 billion, respectively, guaranteed by AMR relating to special facility revenue bonds issued by municipalities.

(b) American has 253 aircraft under operating leases. The AMR Eagle carriers operate 167 regional aircraft under operating leases.

(c) Includes \$135 million guaranteed by American.

USAir Group, Inc.

At December 31, 1992, obligations under capital and noncancelable operating leases for future minimum lease payments were as follows (in thousands):

	Capital Leases	Operating Leases
1993	\$ 46,109	\$ 767,624
1994	34,464	734,732
1995	26,264	729,323
1996	22,444	705,601
1997	21,691	712,264
Thereafter	<u>49,049</u>	<u>8,536,220</u>
Total minimum lease payments	200,021	<u>\$12,185,764</u>
Less amount representing interest	<u>63,099</u>	
Present value of net minimum lease payments	<u>\$136,922</u>	

(背面仍有題目,請繼續作答)

Instructions:

(40%)

1. State your assumptions and show your analysis to the following questions:
 - a. Both American and U.S. Air have capital leases. Which airline acquires a greater percentage of its property and equipment through capital leases?
 - b. Which airline appears to have capital lease obligations that extend farthest into the future?
 - c. Why might one airline have a greater reliance on capital leases than the other?
2. State your assumptions and show your analysis to the following questions:
 - a. In addition to capitalized leases, both American and U.S. Air acquire property and equipment through operating leases. Which airline acquires the greater amount of its assets by operating leases, relative to the amount acquired through capital leases?
 - b. Which airline has a greater obligation for operating leases that extend beyond 5 years into the future?
 - c. Why might one airline have a greater reliance on operating leases than the other?
3. With the data given, for which airline can an estimate of the implicit interest rate used in the capital leases be estimated? Compute an estimated interest rate. Does this rate reasonable?
4. Assume that the operating lease payments for 1998 and thereafter for both airlines extend over the 10-year period from 1998 through 2007, in equal annual payments due at the end of each year. Also assume that the appropriate interest rate for capitalization of the operating leases is 10 percent for both airlines. Finally, use an average figure for the operating leases for the period 1993-1997 of \$850 million for American Airlines and \$725 million for U.S. Air.
 - a. What effect would capitalizing the operating leases have on the balance sheets of the two airlines?
 - b. Which company's balance sheet would be affected most? Why?