

**Problem 1**

	1996	1997	1998
Net Income	\$150	\$225	\$315
Capital Expend	\$200	\$250	\$300
Depreciation	\$125	\$190	\$250
Non-Cash Worl	\$300	\$330	\$375
Net Income	\$150	\$225	\$315
- Net Cap Ex (	67.5	54	45
- Chg in WC (	22.5	27	40.5
FCFE	\$60	\$144	\$230
Dividends	\$30	\$45	\$63
Cash Balance	\$130	\$229	\$396

**Problem 2**

Return on Capital in 1998 =  $600 (1-.4)/2000 = 18.00\%$   
 Reinvestment Rate in 1998 =  $(370-300+50)/360 = 0.33333333$   
 Expected Growth Rate =  $18\% (.3333) = 6\%$   
 Cost of Equity =  $5\% + 1.1 (6.3\%) = 0.1193$   
 Cost of Capital =  $11.93\% (.7) + 7.5\% (1-.4) (.3) = 9.70\%$   
 FCFE =  $EBIT (1-t) - (Cap Ex - Depreciation) - Chg in WC = 360 - (370-300) - 50 = 240$   
 Firm Value =  $240 * 1.06 / (.097 - .06) = \$ 6,876$