The statement of cash flows for **Lands' End** is reproduced here:

Lands' End

CASE 7–1
Cash Flow and Free Cash Flow Analysis

LANDS' END, INC. & SUBSIDIARIES
Consolidated Statements of Cash Flows

($ thousands)	FOR PERIOD ENDED Year 9	Year 8	Year 7
Cash flows from operating activities			
Net income	$ 31,185	$ 64,150	$ 50,952
Adjustments to reconcile net income to net cash flows from operating activities—			
Pretax nonrecurring charge	12,600	—	—
Depreciation and amortization	18,731	15,127	13,558
Deferred compensation expense	653	323	317
Deferred income taxes	(5,948)	(1,158)	994
Pretax gain on sale of subsidiary	—	(7,805)	—
Loss on disposal of fixed assets	586	1,127	325
Changes in assets and liabilities excluding effects of divestitures			
Receivables	(5,640)	(7,019)	(675)
Inventory	21,468	(104,545)	22,371
Prepaid advertising	(2,844)	(7,447)	4,758
Other prepaid expenses	(2,504)	(1,366)	(145)
Accounts payable	4,179	11,616	14,205
Reserve for returns	1,065	944	629
Accrued liabilities	6,993	8,755	4,390
Accrued profit sharing	(2,030)	1,349	1,454
Income taxes payable	(5,899)	(1,047)	8,268
Other	1,665	64	394
Net cash flows from (used for) operating activities	74,260	(26,932)	121,795
Cash flows from (used for) investing activities			
Cash paid for capital additions	(46,750)	(47,659)	(18,481)
Proceeds from sale of subsidiary	—	12,350	—
Net cash flows used for investing activities	(46,750)	(35,309)	(18,481)
Cash flows from (used for) financing activities			
Proceeds from short-term debt	6,505	21,242	1,876
Purchases of treasury stock	(35,557)	(45,899)	(30,143)
Issuance of treasury stock	1,845	409	604
Net cash flows used for financing activities	(27,207)	(24,248)	(27,663)
Net increase (decrease) in cash and cash equivalents	$ 303	$ (86,489)	$ 75,651
Beginning cash and cash equivalents	6,338	92,827	17,176
Ending cash and cash equivalents	$ 6,641	$ 6,338	$ 92,827

Required:

a. Lands' End recently implemented a strategy of filling nearly all orders when the order is placed. In what year do you believe the company implemented this strategy and how is the strategy reflected in the information contained in the statement of cash flows?

b. Explain how the following items reconcile net income to net cash flows from operating activities:
(1) Depreciation (2) Receivables (3) Inventory (4) Reserve for returns

c. Calculate free cash flows for each year shown.

d. How does Lands' End use its free cash flow? Do you think its use of free cash flows reflects good financial strategy?

CHECK
(c) Yr 9, $27,510

CASE 7–2
Analysis of Cash Flows for a Dot.Com

Yahoo!

The statement of cash flows for **Yahoo!** is reproduced here:

YAHOO! INC.
Consolidated Statements of Cash Flows

(in thousands)	Year 8	Year 7	Year 6
	YEAR ENDED DECEMBER 31,		
Cash flows from operating activities			
Net income (loss)	$ 25,588	$(25,520)	$ (6,427)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Depreciation and amortization	10,215	2,737	639
Tax benefits from stock options	17,827	—	—
Noncash charges related to stock option grants and warrant issuances	926	1,676	197
Minority interests in operations of consolidated subsidiaries	(68)	(727)	(540)
Purchased in-process research and development	17,300	—	—
Other noncash charge	—	21,245	—
Changes in assets and liabilities:			
Accounts receivable, net	$(13,616)	$ (5,963)	$ (4,269)
Prepaid expenses	2,144	(6,110)	(386)
Accounts payable	515	2,425	1,386
Accrued expenses and other current liabilities	16,688	7,404	4,393
Deferred revenue	33,210	2,983	1,665
Due to related parties	(451)	330	948
Net cash provided by (used in) operating activities	110,278	480	(2,394)
Cash flows from investing activities			
Acquisition of property and equipment	(11,911)	(6,722)	(3,442)
Cash acquired in acquisitions	199	—	—
Purchases of marketable securities	(471,135)	(58,753)	(115,247)
Proceeds from sales and maturities of marketable securities	158,350	86,678	43,240
Other investments	(5,445)	(1,649)	(729)
Net cash provided by (used in) investing activities	(329,942)	19,554	(76,178)

(continued)

CASE 7–2
(concluded)

(In thousands)	YEAR ENDED DECEMBER 31, Year 8	Year 7	Year 6
Cash flows from financing activities			
Proceeds from issuance of common stock, net	280,679	7,516	42,484
Proceeds from issuance of convertible preferred stock	—	—	63,750
Proceeds from minority investors	600	999	1,050
Other	—	1,106	(128)
Net cash provided by financing activities	281,279	9,621	107,156
Effect of exchange rate changes on cash and cash equivalents	288	(380)	(63)
Net change in cash and cash equivalents	$ 61,903	$ 29,275	$ 28,521
Cash and cash equivalents at beginning of year	63,571	34,296	5,775
Cash and cash equivalents at end of year	$125,474	$ 63,571	$ 34,296

Required:

a. Yahoo!'s operations did not produce significant cash flows during Year 6 and Year 7. How does Yahoo! finance its growth in the absence of sufficient operating cash flows?

b. What appears to drive the operating cash flows of Yahoo!?

c. Yahoo! engages in purchases and sales of marketable securities. Why do you believe Yahoo! pursues this activity?

d. Yahoo! reports $33.21 million of deferred revenue. Based on your understanding of Yahoo!'s operations, what do you believe this amount represents?

CHECK
(*a*) Equity financing

CASE 7–3
Credit Analysis for a Leveraged Buyout

The management of Wyatt Corporation is frustrated because its parent company, SRW Corporation, repeatedly rejects Wyatt's capital spending requests. These refusals led Wyatt's management to conclude its operations play a limited role in the parent's long-range plans. Acting on this assumption, Wyatt's management approaches a merchant banking firm about the possibility of a leveraged buyout of itself. In their proposal, Wyatt management stresses the stable, predictable cash flows from Wyatt's operations as more than adequate to service the debt required to finance the proposed leveraged buyout. As a partner in the merchant banking firm, you investigate the feasibility of their proposal. You receive the following balance sheet and supplementary information for Wyatt Corporation. The management of Wyatt further discloses that, following their proposed purchase, they intend to acquire machinery costing $325,000 in each of the next three years to overcome the previous low level of capital expenditures while a subsidiary of SRW Corporation. Management argues these expenditures are needed for competitive reasons.

Required:

a. Using information in the balance sheet and the supplementary disclosures, prepare a statement of cash flows (indirect method) for the year ended December 31, Year 10.

b. Using the statement of cash flows from *a* and assuming that debt service is $300,000 per year after the leveraged buyout, evaluate the feasibility of management's proposal.

CHECK
(*a*) CFO, $269,000

WYATT CORPORATION

Balance Sheets

December 31, Year 10 and Year 9

	Year 9	Year 10
Assets		
Cash	$ 175,000	$ 192,000
Accounts receivable	248,000	359,000
Inventory	465,000	683,000
Total current assets	888,000	1,234,000
Land	126,000	138,000
Building and machinery	3,746,000	3,885,000
Less accumulated depreciation	(916,000)	(1,131,000)
Total assets	$3,844,000	$4,126,000
Liabilities and Shareholders' Equity		
Accounts payable	$ 156,000	$ 259,000
Taxes payable	149,000	124,000
Other short-term payables	325,000	417,000
Total current liabilities	630,000	800,000
Bonds payable	842,000	825,000
Total liabilities	1,472,000	1,625,000
Common stock	846,000	863,000
Retained earnings	1,526,000	1,638,000
Total shareholders' equity	2,372,000	2,501,000
Total liabilities and equity	$3,844,000	$4,126,000

Supplementary Information:

1. Dividends declared and paid in Year 10 were $74,000.
2. Depreciation expense for Year 10 was $246,000.
3. Machinery originally costing $61,000 was sold for $34,000 in Year 10.

(CFA Adapted)