

Problem S1

(Cousin calls) Your cousin is considering investing in Broadband Leaders (BL) a growing internet company that is selling ADSL service in competitive long-term packages. He read briefings about BL's performance in the last quarter which indicate that the company's net cash flow from operations is positive but its net income is negative (indicating a loss). Puzzled with this "contradiction", he called you and asked for clarification.

- (a) Explain to your cousin, in no more than 5 lines, why a company can have positive cash flow while realizing a loss.
- (b) For BL's case, give one possible reason for the positive cash flow and negative income performance in the last quarter.

Problem S2

(Indirect in retail) Suppose a retail company makes its purchases in cash and typically sells purchased items within few months. The company utilizes the indirect method for constructing the cash flow statement. Suppose that the inventory asset has increased by \$1,000, on the balance sheet of December 31, 2008 relative to that of December 31, 2007.

Explain intuitively, *without* utilizing the formal method based on the accounting identity discussed in class, why should the \$1,000 change be subtracted from net income to obtain cash flows from operations in 2008. (Limit your answer to 8 lines.)