6. Elmdale Enterprises is deciding whether to expand its production facilities. Although long term cash flows are difficult to estimate, management has projected the following cash flows for the first two years (in millions of dollars):

Year 1 year 2

Revenues 125 160

Cost of goods sold and operating

Expenses other than depreciation 40 60

Depreciation 25 36

Increase in working capital 5 8

Capital expenditures 30 40

Marginal Corporate tax rate 35% 35%

1. What are the incremental earnings for this project for years 1 and 2?
2. What are the free cash flows for this project for this first two years?

9. Markov manufacturing recently spent $15 million to purchase some equipment used in the manufacture of disk drives. The firm expects that this equipment will have a useful life of five years, and its marginal corporate tax rate is 35%. The company plans to use straight -line depreciation.

a. What is the annual depreciation expense associated with this equipment?

b. What is the annual depreciation tax shield?

c. Rather than straight-line depreciation, suppose Markov will use the MACRS depreciation method for five years property. Calculate the depreciation tax shield each year for this equipment under this accelerated depreciation schedule.

d. If Markov has a choice between straight line and MACRS depreciation schedules, and its marginal corporate tax rate is expected to remain constant, which should it choose? Why?

e. How might your answer to part (d) change if Markov anticipates that its marginal corporate tax rate will increase substantially over the next five years?