**Susan’s Lemon Stand**

DETERMINING PURCHASE PRICE

Susan (Seller) will sell her lemon stand to Bea (Buyer). Susan has set up a corporation wholly owned by her and transferred all the assets and liabilities of the lemon stand to the corporation (Target). The balance sheet of Target on the signing date is as follows:

BALANCE SHEET AT SIGNING

Assets:

Cash $10  
 Receivables from customers $20 (Target sells lemonade on credit!)  
 Lemonade $20  
 Table $50  
  
 TOTAL ASSETS $100

Liabilities

Payables for lemons $10 (the store extended credit to Target)  
 Debt to Mom $50

Equity

Susan Equity $40  
   
 TOTAL EQUITY PLUS LIABILITIES $100

Susan and Bea agreed that it is reasonable to assume that Target will generate cash flows of $100 in each of the following five years. They also agree that:  
(A) Target will have a terminal value of zero and (B) an appropriate discount rate reflecting the alternative investment opportunities of Bea (3%) and the risk that the cash flows will be lower (7%) is: 10%. Based on the foregoing, Susan and Bea agreed that (X) the **Enterprise Value** of Target is: $379.08, (Y) Target will be acquired on a **debt free cash free basis** and (Z) at closing, Target should have a working capital equal to the working capital it had at signing ($20).

*Given the foregoing what should be the purchase price for the equity of Susan in Target? [Remember that EV= Equity + Net Debt and therefore Equity = EV- Net Debt and Net Debt = Debt minus Cash].*

DETERMINING THE WORKING CAPITAL ADJUSTMENT

90 days after closing, Susan and Bea finally agree that the balance sheet of Target on the closing date was as follows:

CLOSING BALANCE SHEET

Assets:

Cash $0  
 Receivables from customers $30 (Target sells lemonade on credit!)  
 Lemonade $20  
 Table $50  
  
 TOTAL ASSETS $100

Liabilities

Payables for lemons $30 (the store extended credit to Target)  
 Debt to Mom $50

Equity

Susan Equity $20

*(A) If Susan and Bea have agreed to apply a NY-style purchase price adjustment, calculate what the adjustment will be (remember that the target working capital was $20)?Who will pay money to whom and how much?*

*(B) If Susan and Bea have agreed to use a lock box approach instead, will there be an adjustment if there was no leakage? What will be the adjustment if Susan paid herself a dividend of $20 between signing and closing?*