Starbucks financial analysis 2019

Business, Company

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A client is working with a financial manager to research various stocks and choose one to invest in. The financial manager has spent a lot of time with the client to determine what kind of risk they are willing and able to take in their portfolio. This paper will outline the steps taken by the financial manager to choose the appropriate stock for investment as well as the historical and current financial performance of the stock.

Stock Rationale

Thefinancemanager is researching Starbucks Corporation (SBUX) for the client to consider investing in. Starbucks Corporation (SBUX) is a very strong and well-known brand. It roasts whole bean coffees and sells it along with various gourmetfooditems. It also sells licensed products in supermarkets and convenience stores. Starbucks has been in business for over forty years and is a top brand leader. It employees approximately 291, 000 employees (Zacks, 2019).

The client is looking for a strong stock to start their portfolio. Theirgoalsare long-term and SBUX is a strong and steady performer (Forbes, 2012). SBUX has approximately 1. 2M shares outstanding with a market capitalization of approximately $81. 5M. Market capitalization measures how large a company is by multiplying its outstanding shares by the stock price. Based on the size of Starbucks ' market cap, they are considered a large-cap company. This is helpful as typically large-cap companies have more assets and capital and are inherently lower risk (The Motley Fool, 2019).

Many financial analysts and agencies publish Beta for stock traded in the market. Beta is the relevant measure of the risk of the stock in the open market. When a stock carries a high Beta, it contributes a high amount of risk either on its own or in a portfolio. The average beta for all stock is 1. 0. If a stock carries a beta of 1. 6, it means that this stock contributes 60% more risk than the average stock (Brigham & Ehrhardt, 2017).

The current beta for Starbucks Corporation is 0. 48. This stock is a very low risk at the current time. A low beta means the stock will rise less than the market if the market increases. Over the last five years, the trend for Starbucks shows it is typically stable to changes in the market. The lowest beta was 0. 48 in October 2019 and the highest was 1. 25 in February 2014 (Zacks, 2019).

The high beta of 1. 25 in 2014 indicates that the stock would react 25% more to the market than the average stock with a 1. 0 beta. A negative beta has a reverse reaction to the market than a positive beta. If the market goes up, the stock will decrease in value and vice versa. Starbucks is on par with the industry average of 0. 47 (Zacks, 2019).

Based on the current beta of 0. 48 for Starbucks, if the market increases today by ten percent, its stock will increase by 4. 8% or 48 cents for every $1 the market increases (Yahoo Finance, 2019). If the market went up 10% back in February 2014 when Starbucks' beta was 1. 25, the stock would have grown $1. 25 for every increase of $1 in the market (Zacks, 2019).

As the client is looking for a strong, low-risk stock to start their portfolio, SBUX should fit those criteria. The current stock price is $65. 70 with a 52 week high of $68. 98 and a low of $47. 37 (Zacks, 2019).

Client Profile

The financial manager spent a lot of time reviewing the client's financial profile and investment goals. It is necessary to look at their current statuses such as income, expenses, assets, liability, and tax issues (Investopedia, 2019).

The client is a young single male, age 28, who has not yet reached the peak of his earning potential. He has received an inheritance of $400, 000 in cash and a mortgage-free home. Expenses for this investor are extremely low at approximately ten percent of his base salary. He does not need to invest for income purposes. The client is interested in funding long term goals such as a wedding, potential college funds for children, and retirement.

The client is new to investing in stock and is not familiar with financial terminology or what to look for in a stock. His recent inheritance was unexpected and since he has assets and limited liabilities, he is looking to grow his portfolio with limited risk. Although based on age and earning potential he could withstand a higher risk portfolio, he does not need immediate income and his goals are long term.

Starbucks has a bond rating of Baa1 from Moody’s (Moody's, 2019). Standard and Poor’s (S; P) gives Starbucks a rating of BBB+ (Standard & Poor's, 2019). Bond-rating agencies evaluate companies and assign a bond rating based on creditworthiness and probability of default. The ratings range from AAA which is the strongest and most favorable to D which is the weakest. Agencies look at financial ratios such as return on invested capital, debt ratio, and interest coverage ratio to determine if the company is experiencing financial strain. Bond contract terms are reviewed to determine how the bond is secured. Qualitative factors such as how a company is affected by economic or environmental issues are evaluated as well (Brigham & Ehrhardt, 2017).

The bond rating provided by Moody’s was downgraded from A 3 back in June 2019 as they deemed Starbucks’ increased debt as an increase in risk (Moody's, 2019). While this credit rating is important for Starbucks to obtain financing if needed, it does not paint a picture of a declining stock investment.

Financial Ratios

To further support recommending SBUX as the stock to add to the client’s portfolio, the financial manager calculated and analyzed several financial ratios. These ratios can help determine a company’s financialhealthand dig

deeper than theirfinancial statementshow (Brigham & Ehrhardt, 2017). All calculations of these ratios for Starbucks are included in the attached workbook provided to the client.
The first ratios to be analyzed are liquidity ratios. These ratios help determine if a company has enough cash to meet its financial obligations (Brigham & Ehrhardt, 2017).

The current asset ratio compares the number of liabilities to assets. Assets include cash, inventories, and accounts receivables while liabilities include accounts payable, long-term debt, and other expenses. The ratios are calculated by diving current assets by current liabilities. Starbucks has increased its current ratio from 1. 05 in 2016 to 1. 25 in 2017 and 2. 20 in 2019. Starbucks has become more liquid over the past three years allowing investors to build confidence in their ability to pay off their debt.

The quick ratio is similar to the current ratio, however, it subtracts inventories from assets. Inventories are not always easy to convert to cash if needed. They are the least liquid of a company's assets and a strong quick ratio shows a company can pay off their obligations quickly without relying on selling inventories (Brigham & Ehrhardt, 2017). Starbucks' quick ratio in 2016 was 0. 74. It increased to 0. 93 in 207 and jumped to 1. 95 in 2019. Another supporting test for this company's strength.

Asset management ratios can help to assess how well a company manages its assets and whether they have enough assets to generate sales. Asset management ratios also help to measure efficiency. One ratio used to determine the amount in sales generated for the amount that is tied up in assets is called the total assets turnover ratio. This ratio is calculated by dividing sales by total assets. The higher the ratio, the better. A ratio of 1. 0 means that a company has $1. 00 in sales for every $1. 00 invested in assets (Brigham & Ehrhardt, 2017).

Although Starbucks has decreased its total asset turnover ratio over the past three years from 1. 49 in 2016 to 1. 02 in 2019, when compared to the industry and in particular, Dunkin Brands Group Inc. (Dunkin), they are well above the average. Dunkin Brands has a total asset turnover ratio of 0. 22.

The fixed asset turnover ratio is similar to the total assets turnover ratio except it uses net fixed assets instead of total assets. It looks at how well the company uses plant and equipment and what its return on investment is (Brigham & Ehrhardt, 2017). The ratio for Starbucks has declined year over year from 4. 70 in 2016 to 4. 55 in 2017 and 4. 17 in 2019. This is showing that Starbucks generates over four and a half times more sales than their net assets. This is comparable to competitors such as Dunkin which had a ratio of 5. 09 last year (Zacks, 2019).

Since the historical costs of the assets are used in the fixed asset turnover calculation, inflation can have a profound effect on the ratio. The financial manager needs to be aware of material price fluctuations (Brigham & Ehrhardt, 2017).

Profitability ratios measure how well a company generates earnings in comparison to their expenses and how much of those earnings are profit. The profit margin on sales is calculated by dividing net profit by total revenue. This is a straightforward calculation as both numbers are found on the income statement and the higher the margin, the better (Brigham & Ehrhardt, 2017).

Starbucks has increased its profit margin significantly over the last year. It has grown from 12. 9% in 2017 to 18. 3% in 2019. Although net margin has grown over the last three years for Starbucks, it is falling short of its competitor Dunkin which sits at a 30. 28% margin for 3Q 2019.

Now that asset management and profitability have been analyzed, the financial manager can look at solvency and calculate total liabilities as a percentage of total assets. Investors should know how many assets would need to be sold to cover liabilities. This can be measured by using debt management ratios (Brigham & Ehrhardt, 2017).

The debt ratio is calculated by dividing total liabilities by total assets. A ratio of one indicates the company would need to sell all assets to pay its liabilities. Starbucks' debt ratio has increased from 0. 59 in 2016 to 0. 95 in 2019. While this is not considered favorable at face value, in comparison to Dunkin, they are on par. Dunkin's debt ratio was 1. 0 last year (Zacks, 2019).

In terms of market value, Starbucks is keeping up with its competitors. Market value ratios help investors compare a company's stock to competitors (Brigham & Ehrhardt, 2017).

Earnings per share (EPS) is a common value calculated to measure net income per share of outstanding stock. To determine EPS, preferred dividends are subtracted from net income and then divided by the weighted average of common shares outstanding. Starbucks' EPS has consistently increased from $1. 91 in 2016 to $2. 42 in 2019. Their primary competitor, Dunkin, has a current EPS of $2. 84 (Zacks, 2019). While Dunkin's EPS is slightly higher, Starbucks has been trending upward. Although a higher EPS is good, it does make the price per share increase as well (Brigham & Ehrhardt, 2017).

The price-earnings (P/E) ratio examines the market value of a stock. If an analyst can predict a stock's future earnings, it can help analyze the fair market value. The calculation for P/E is dividing the price per share by the earnings per share. This fluctuates daily. As of November 20, 2019, Starbucks has a P/E of $27. 15. This is stable from last year but down from $29. 07 in 2016 (Zacks, 2019).

Risks

Based on the financial manager's assessment, the risk of investing in Starbucks is low. Its beta is very low, the brand is strong and over the last five years, the dividends have been consistent. The stock price has increased in the five-year trend as well (Yahoo Finance, 2019).

Starbucks' starting price per share was $17 in 1992 when it went public and has grown to $65. 70 per share (Starbucks Corporation, 2019).
In looking at a SWOTT analysis (strengths, weaknesses, opportunities, threats, and trends), the weaknesses are very low. Primarily, weaknesses include the price point of Starbucks' products compared to its main competitor Dunkin. Fluctuation in the price of raw materials, i. e. coffee beans, can affect profits. Outside threats, particularly political tariffs or taxes

when sourcing from other countries can be a concern to investors. Social stigma can sway consumer behavior and weigh heavily in investor perception of the brand (Lemus, von Feigenblatt, Orta, & Rivero, 2015).

The financial manager has not taken the potential risk lightly but has determined the strengths and opportunities outweigh the risk. With over 40 years in the business and 29, 324 stores in over 78 countries (as of Q4 FY18), Starbucks has proven strength and longevity against a fierce competitor with cheaper product pricing.

The financial manager does not foresee any major risks for the client to invest in this stock. Since the client is new to investing in stocks, any perceived risk can be remedied by diversifying the portfolio. Starbucks is a strong brand that the client can easily follow and identify.

Analyst Reviews

Starbucks has experienced a positive trend in the last quarter of fiscal 2019 surpassing many analyst’s expectations. EPS grew over 13% year over year driven by a stellar performance in the Americas as well as a turnaround in business in China. Starbucks opened 604 new stores globally in the last quarter alone (Research, 2019).

Although margin has trended downward year over year due to investments impacted by U. S. tax law changes and some food product shifts, the financial manager points to the continued growth as a tool to overcome some speed bumps (Research, 2019).

Outside analysts also note a 15% increase in membership in the My Starbucks Rewards Program. Members receive discounts and free perks based on the amount they spend. Customers are also taking advantage of mobile ordering, allowing them to order and pay for their drinks through a mobile application and have it ready upon their arrival. Approximately 14% of all U. S. transactions were paid via mobile application (Research, 2019).

The financial manager agrees with outside analysts that based on Starbucks' expected future growth of 3-5% and planned addition of 2, 100 new stores, Starbucks is a solid investment for this client (Research, 2019).