

Capital structure essay sample



My company choice is Nike Inc. (Nike), a multinational sports footwear, equipment and apparel manufacturing company based in Oregon, United States. This puts Nike in the apparel industry. In 2010, Forbes rated Nike as the top sports business with a total value of \$10.7 billion.

The most effective marketing strategy Nike employ is the sponsorship agreements they have with numerous top athletes in a variety of sports.

Operating Risks of Nike

When Nike was initially started out, the aim was to improve the social, labor and environmental impacts the business has, motivated by the need to manage risks. However they have also incorporated innovation to help make Nike a more sustainable business that involves the people, planet and profit in order to ensure long lasting success.

One of the major operating risks is the need to continuously keep in touch with the ever-evolving sports world, as well as the demand of consumers who are constantly demanding new products and services.

Financial Risks of Nike

The strong indication of a company's financial risks is the debt to total capitalization ratio. This ratio measures the portion of a company's total capital structure that is financed by debts.

The ratio is calculated as:

According to the balance sheet dated May 31, 2014, Nike had a total debt of \$1.373 billion, and total shareholders' equity of \$10.824 billion. Computing these numbers gives a debt to total capital ratio of 11.26%.

The balance sheet of Nike shows that there is no preferred stock offered by the company but their common stock number stands at 3 million. Also, because there are no preferred stocks, it is impossible to calculate the cost of this type of stocks.

Capital Structure of Nike

This section gives a brief analysis of Nike's capital structure. As stated earlier, Nike has a debt to capitalization ratio of 11.26%; meaning only 11.26% of Nike was been financed externally as of May 31, 2014. This shows Nike is a low risk company for both its owners and investors. Nike currently has short-term debt of \$174 million and long term debt of \$1.199 billion.

Nike shares are traded on the New York Stock Exchange (NYSE) market. As at 4:00PM EDT on September 19, 2014, Nike's common shares were trading for \$81.81, a \$0.16 change in price during the day, but after hours activities saw the price drop a further \$0.19 to \$81.62.

The Beta is a measurement of the volatility and fluctuation of a company's stock relative to the market. Given the market beta of 1.0, if a company has beta greater than 1.0 it means the company's stocks are more volatile than the market, making the company riskier but they also pay higher returns. On the other hand, beta lower than 1.0 indicates less volatility than the market, making them less risky but also paying investors lower return.

NASDAQ and Yahoo Finance both report different beta figures for Nike. According to NASDAQ, Nike has a beta of 1.12, while Yahoo Finance reports the beta as 0.72. Since Yahoo Finance uses figures from the NYSE (the market Nike trades in), that is the beta figure to use. This figure indicates Nike is less risky than the market, but returns are lower than market rate.

Cost of Equity

The cost of equity of a company is the numerical indication of the return the stockholders demand for their investment in the company. The most popular way of calculating the cost of equity is using the dividend capitalization model. The formula for this method is: $(\text{Next Year's Annual Dividend} / \text{Current Stock Price}) + \text{Dividend Growth rate}$

Morningstar reports the annual dividend payable on October 6, 2014 as \$0.24 per share, while a year earlier on October 4, 2013 the current stock price closed at \$72.14. According to NASDAQ, between October 7, 2013 and October 6, 2014 the dividend increased from \$0.21 to \$0.24 per share, a 14.28% increase. Putting these figures together, the Cost of equity of Nike Inc. as of October 2013 was 14.61%.

Cash Dividend Yield

The dividend yield is a ratio that measures the amount of cash generated for each dollar invested by the shareholders. The higher this ratio, the higher the amount of dividend that a shareholder earns for each dollar invested, making it more enticing to profit chasing investors.

YCharts plots a graph showing the change in the dividend yield based on the change in share price on a daily basis. On September 19, 2014 the yield of Nike Inc. was at 1.17%.

Stock History of Nike

In the previous 5 years, Nike has enjoyed continuous success as it has experienced a steady rise in stock prices (except for small period of share price drop), starting at \$29.32 on September 21, 2009 to its current highest point of \$81.81 on September 20, 2014.

Analysis and Investment Decisions

Taking a look at the total capital structure of Nike, as well as its operating and financial risks, Nike seems to be in a good position. With a relatively low debt to capitalization ratio of 11.26%, Nike are heavily internally financed by shareholders, so they are not operating at a high risk in terms of having enough resources to cover their debts, both short-term and long-term.

Looking at the balance sheet of Nike over the last three years, although cash and cash equivalent have been volatile and fluctuating yearly, the total assets have been increasing, to match the increasing total liabilities owed by Nike.

The ever-evolving market, along with the economic, social and political factors that affect business performances, constantly threatens Nike, like any other company.

In conclusion, it can be concluded that Nike is a relatively low risk company. This is backed up by the beta figure of 0.72 that indicates Nike is less risky than the market but also with a low return rate, as indicated by the low dividend yield figure.

The decision to invest in Nike would be dependent on the intentions of the shareholders and other investors. As stated earlier, Nike is a low risk company with low return rates, indicating it will be unsuitable for profit-motivated investors. It is indicative that Nike is more concerned about sustainability and continuous growth.

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