Stage 4 of the Project: Campbell Soup (CPB)

Student’s name

Course name and number

Instructor’s name

Date

**Part 1: Campbell Soup Bond performance**

Assume that the par value of the securities is $1,000 and that the bond prices are $109.0 and $100.7 at 4.25% and 3.3% respectively. I would invest in the security that attracts an interest rate of 4.25% compared to 3.3%. The current bond yield when the interest rate is 4.25% is 39%. The yield to maturity is 84% at a four year period. When the rate is 3.3%, the bond yield reduces to 33%. The yield to maturity also reduces to 47% at an eight year period. I would still invest in the security even if it was called. The yield to call is more than the yield to maturity (see table 1 and excel workings). An increase in interest rate has a negative impact on the bond. If the interest rate increases to 6%, the investors will be willing to invest in the issued bond compared to when the bond holder sells the 4.25% bond. The bondholder will definitely not sell the 4.25% bond below the face value. There are losses if the bond holder decides to increase the rate beyond the initial value. If the bond is withheld, the holder will still realize loss as the interest earned will be lower than the market rate.

**Table 1: Bond performance**

|  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Name | Maturity date | Amount $ Mil | Price | Last bond prices | Coupon % | Interest payments (annual) | Bon yield | Yield to Maturity | Yield to Maturity | Bonds prices | Capital gain | Yield to call |
| Campbell 4.25% | 04/15/2021 | 1,000.0 | 109.0 | $ 1,090.00  | 4.250 | $ 42.50  | 39% | 1.79 | 0.84 | $323.32 | $676.68  | 4.47 |
| Campbell 3.3% | 03/19/2025 | 1,000.0 | 100.7 | $ 1,007.00  | 3.300 | $ 33.00  | 33% | 3.20 | 0.47 | $180.05 | $819.95  | 4.67 |

Source: (MorningStar, 2017)

**Part 2: Financial Leverage Ratios**

Finance leverage ratios are used to assess how a firm is financed by comparing the debt to the total assets, debt to equity, and its ability to account for interest including fixed charges. The debt ratio indicates the amount of total assets which are financed using total debt. Campbell relies on debt as the main capital source. The number of assets funded using debt capital increased from 2014 to 2015 however, it reduced in 2016. The debt to equity ratio also recorded a similar trend (table 2). Overall, the firm was able to lower its risk because of the reduction in debt ratio and debt to equity ratio in 2016 compared to 2015. Reduced debt to equity ratio in 2016 reflects that the debt holders had less claims on Campbell’s assets during that year. There was an improvement in the Campbell’s ability to accounts for its interest and fixed charges in 2015 compared to 2014. However, the interest coverage ability reduced 1.79. Overall, it is advisable not to invest in the company’s bonds as they are risky. Although the debt ratio reduced in 2016, it is now 0.46 and is more than the industry average ratio of 0.33 (MorningStar, 2017). Its debt to equity ratio now stands at 2.29 and is higher than the industry average ratio of 0.81.

 **Table 2: Campbell’s leverage ratios**

|  |  |  |  |
| --- | --- | --- | --- |
|  | 2016 | 2015 | 2014 |
| Debt ratio | 0.45 | 0.51 | 0.49 |
| Debt to Equity ratio | 1.52 | 1.85 | 1.39 |
| Interest coverage ratio | 8.38 | 10.17 | 9.80 |

(MorningStar, 2017a

**Part 3: Campbell’s stock performance**

 **(1) Market ratios**

The market ratios are used to analyze the stock prices of companies and the return on investment. Statistically, Campbell’s earnings per share tend to decline after a rise. This is supported by 2012 and 2013 share price earnings which stagnated at around $2.42. It fell to $1.44 in 2014. It again rose in 2015 before falling in 2016. As a result, the dividends earned between 2014 and 2016 were constant at $ 1.24 (table 3). Additionally, the book value contradicts with the earnings per share. The book value per share for the three years is more than the per share earnings. Moreover, as the earnings fluctuate, the book values increase. On the other hand, the company’s price to earnings ratio annually increased in the last three years. On average, its price to earnings ratio which is 32.8 is above the industry average ratio of 28.4 (MorningStar, 2017a). It is therefore unlikely, that investors will invest in Campbell’s stock prices. The investors value a low price to earnings ratio. They are willing to pay a low price on a stock that offers high earnings. The stock prices to the cash flow are also low compared to the industry average, an implication that the prices are not adequately covered by the cash flow. Generally, the generated return on investment is low because of declining earnings per share, high price to earnings ratio, and constant dividends paid.

**Table 3: Campbell’s market ratios**

|  |  |  |  |
| --- | --- | --- | --- |
|  | 2016 | 2015 | 2014 |
| Earnings per share | 1.81 | 2.13 | 2.74 |
| Price to earnings ratio | 28.4 | 25.6 | 17.6 |
| Dividends | 1.24 | 1.24 | 1.24 |
| Book value per share | 5.44 | 5.14 | 5.10 |

|  |  |  |
| --- | --- | --- |
|  | BLL | Industry Average |
| Price/Earnings | 32.8 | 28.4 |
| Price/ Cash flow | 12.7 | 15.1 |

(MorningStar, 2017a)

**(2) Stock prices analysis**

The stock prices of Campbell indicate a tremendous decline in the past one year as illustrated by the diagram below. In July 5, 2016, it traded at $67.19. The values drastically went down reaching $53.00 by October 27, 2016. It again picked up recording $60.47 by December 30, 2016. Although there was a consistent increase at around $3.00, it reduced to around $59.00 between February and March 2017 (Yahoo! Finance, 2017b). There was a further decline between May and June this year and is now trading at $52.15 (see excel stock prices). It is notable that when the stock is traded at high volumes, the stock price reduces and vice versa. On January 5, 2017 for example, the volume was 1,488,500 closing at $60.93. The price was $51.99 on June 29, 2017 when the volumes traded were 2,844,000. The investors should not purchase the stock. A deteriorating stock price reveals that the investors lack confidence in Campbell’s common stock.

**(3) Required rate of return (R) using CAPM**

The required rate of return on Campbell’s common stock is 3.25% (working). There is a big difference between the calculated rate of return which is 3.25% and the change in Campbell’s stock price over the last 52 weeks which is -22.62% (Yahoo! Finance, 2017b). Overall, the company’s stock is overvalued. The presented percentage change is less than the required rate of return. The company had high expectation about the return however; a low return was earned due to the stock’s perceived riskiness. It is recommended not to invest in overvalued stocks. In Campbell’s scenario, the market price is more than the intrinsic value. Most probably, the stock market price will decline to align with the firm’s true value.

**Working: Required Return**

Rate of return on treasury composite (Rf) 2.26% (Yahoo! Finance, 2017)

Expected rate of return on market portfolio (Rm) 10.5%

Systematic risk (β) of common stock 0.12 (Yahoo! Finance, 2017b)

R=Rf+ β (Rm-Rf) =2.26%+0.12[10.5%-2.26%] =3.25%

References

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