Part II – Portfolio Summary

I. The stocks selected were based on the approach of long-term prospects for growth, as well as by a weighted rating as covered by analysts. In addition, the stocks came from varying industries or sub-industries, as to mitigate risk arising from a downturn in a particular industry. The logic for each stock was as follows:

a. **Delta (DAL)**: Cheap oil that was forecast to stay throughout 2015 would reduce costs for Delta. While Delta does hedge fuel, this still meant that Delta would spend less on the futures is would buy during 2015 than in would have a few months earlier. Delta had just released quarterly earnings at the time, and in a responsible statement by its CEO had said it planned to pay down debt, freeing future cash flow for growth or investors. Three out of three analysts rated "buy" (source used for ratings coverage was Yahoo Finance) with median one year price target at $62.94.
b. **Target (TGT)**: Continued improvement in the economy, lower gas prices, and consumer confidence should boost retail sales throughout 2015. In addition Target closed their Canadian operations, which would have a short-term drag on profits during the exit of Canada, but will boost the overall margin and EPS of the company in the future.
c. **JPMorgan Chase (JPM)**: With a rough 2014 behind it (JPM paid massive amounts out in government fines and penalties) JPM should increase its net income and EPS in 2015 with an improving economy and reduced costs. In addition six of nine analysts rated "buy" with mean one-year target of $67.67. The stock had also reached a 52 week low, creating a buying opportunity given that net income was expected to rise.
d. **Google (GOOGL)**: Consistently delivers innovative products and has incredible market penetration with products such as Gmail, YouTube, Maps, and its search engine service. These make the stock a solid buy, with nine out of twelve analysts rating it "buy" as well.
e. **Starbucks (SBUX)**: America's obsession with coffee continues, making growth opportunities still possible, in addition SBUX has been innovative in recent years by diversifying its product line to create continued growth opportunities. The stock was rated by seven out of eight analysts "buy."

II. The weighted Beta of the portfolio is calculated as:

Company	Beta	% of Portfolio	**Weighted Beta**
Delta	0.77	19.7	0.15
Target	0.87	18.4	0.16
JPM	1.81	18.1	0.33
Google	0.80	25.5	0.20
Starbucks	0.98	18.3	0.18
Totals		100	**1.02**

III. <u>Using Beta as a benchmark, the portfolio did take on slightly more risk than The Market.</u>
Market Beta = 1.0
Portfolio Beta = 1.02
Excess Risk: 1.02 – 1.0 = .02 or 2%

IV. <u>Using Beta as a benchmark, the portfolio did outperform the Market.</u>
S&P 500 performance for the period (Market Return): 2.24%
Expected return of the portfolio (Beta x Market Return): 1.02*2.24% = 2.28%
Actual return of portfolio: 7.21%
Percentage that portfolio outperformed the Market: 7.21% - 2.28% = **+4.93%**

V. What I've learned from playing the investment game, is that with some research you can certainly obtain a return in excess of the market, but probably not wise to do so with one, or even a five security portfolio. Some of my stocks gained more than what I anticipated, while others gained less than what I anticipated. As we've learned, about 80% of unique risk can be diversified away with a portfolio of 18-25 securities.

While I feel my logic used in selecting stocks was sound, I would have done a couple things differently looking back. I used a long-term return prospect in choosing my stocks, but given this project only ran for about ten weeks, I think I may have been thinking too long-term for it to be fully effective in such a short amount of time. If I started over, I think I would have researched the things that were being said during the last earnings statements, and looked for a company or two that we could expect to get a short-term bump in revenues or stock price.

STARBUCKS

Part III – In Depth Company Analysis
Starbucks (SBUX)

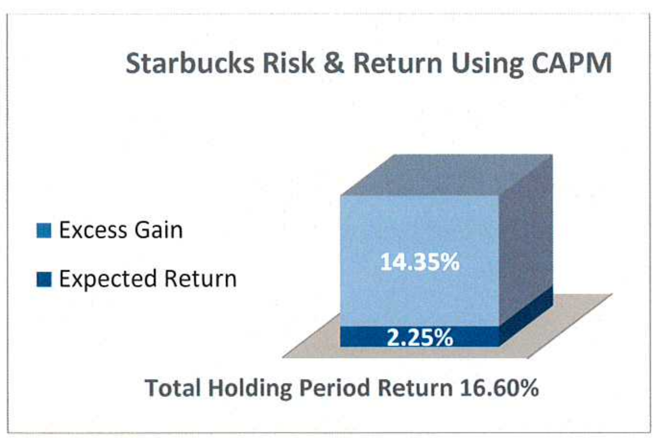
Business Model Analysis

Starbucks' business model has positioned it well in the current economic climate, as well as for the reasonably foreseeable future. Starbucks' primary revenue generator is making and selling premium coffee beverages. There has been a dramatic shift in tastes worldwide over the past decade that has positioned Starbucks to capitalize on coffees. In addition, not only is Starbucks attractive to the middle class American (and above); based on its successful marketing as a premium beverage operator that they can frequent. But it also attracts many working class Americans (and below), as an operator that can be occasionally visited as a "splurge" or treat. Starbucks has also built a sterling reputation as a company with a good sense of social responsibility. Caring for the environment, it's sourcing, domestic issues, and its employees. Popular topics among consumers that has put Starbucks in a favorable light.

In recent years Starbucks has been maturing as a coffee operator but has found great ways to grow revenue through diversifying its line of products into premium teas, bakery foods, and logo merchandise. They still occasionally continue to deliver on the coffee front as well, by introducing new products such as Starbucks Single Origins.

Risk/Return Analysis

Investors invest for anticipated future returns. However, these returns can only be predicted upon best guesses of external and internal factors that may be affecting a company. There will always be risks associated with an investment. One measure of a company's risk, in relation to the Market, is its Beta. Beta is a number between 0 and 2 that measures the variability of a stock relative to what the Market (S&P 500) is doing. This is an attempt to measure risk that is below or in excess of the systemic risk of the Market. For example, Starbucks Beta of 0.98 suggests that the stock should have 98% of, or 2% less risk than that of the Market. Using Beta, the Risk Free Rate, and returns on the S&P 500 to calculate CAPM, we conclude that the expected return for the amount of risk taken should have been **2.25%** during my project investment period:
2.50% Rrf +B 0.98 (2.24% Rm - 2.50% Rrf) = 2.25%.
The stock really produced at 16.60% beating the expected return by a whopping 14.35%. Typically, we would expect to have a higher Beta for a stock with so much growth, but Starbucks' consistent performance has kept risk in check.



Financial Statements Ratio Analysis (FY 2014)

Liquidity:

Current Ratio (Current Assets / Current Liabilities)
A current ratio above 1.0 puts a company in a good position to pay its short-term obligations, while a current ratio below 1.0 could signal liquidity problems within a company. Starbucks has a healthy Current Ratio of 1.28 that's in line with other industry leaders such as Dunkin Donuts (1.25).

Profitability:

Return on Assets (EBIT [Operating Income less Expenses]/ Average Total Assets)
ROA is an indicator of how well a company is using its assets to produce income for investors. Starbucks has an ROA of 16.17%, putting it far ahead of competitors such as Dunkin Donuts (6.2%).

Profit Margin (EBIT / Sales)
Starbucks' profit margin comes in at 14.76%, quite a bit lower than Dunkin's 23.56%; however this was on revenues of 17.01B vs. 748.7M, indicating Starbucks has a larger cost curve as a company with nearly 23 times the revenue. Starbucks larger revenues produced greater Net Income and an Earnings per Share ratio that almost doubled Dunkin Donuts at 3.31 vs. 1.66 respectively.

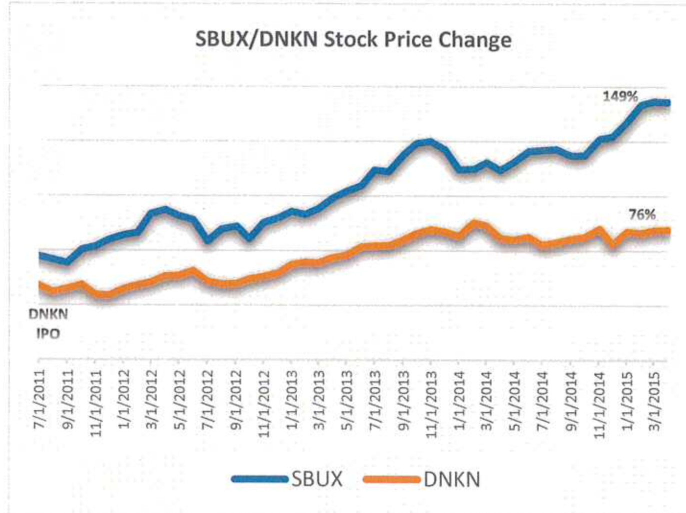
Market Valuation:

Price-to-Book or P/B (Market Price per Share / Stock Holder Equity per Share)
A lower P/B ratio could signal that you've found a stock that is undervalued. However, this varies widely from industry to industry so it's important to compare to like companies. A lower P/B could also signal that investors are avoiding the stock for some reason, so it's always wise to look at financials before using P/B to make an investment decision. Starbucks' P/B is 12.26 vs. 13.45 for Dunkin Donuts. Knowing that Starbucks is in a healthy financial position, this could signal there are additional gains still to come from the stock.

Price-to-Earnings Ratio or P/E (Market Price per Share / Earnings per Share)
The P/E ratio can be an indicator of what investors are expecting from a company. P/E is a multiple of earnings; it's the price you're willing to pay for a current dollar of earnings. Therefore, a higher P/E typically means that higher earnings are expected from a company by investors. As with any ratio, it's wise to compare P/E's within the same industry, as they vary. Starbucks P/E is currently at 28.66 and has been on a steady march in 2015, compared to Dunkin's 28.92, Starbucks' stock could still be slightly undervalued by this measure as well.

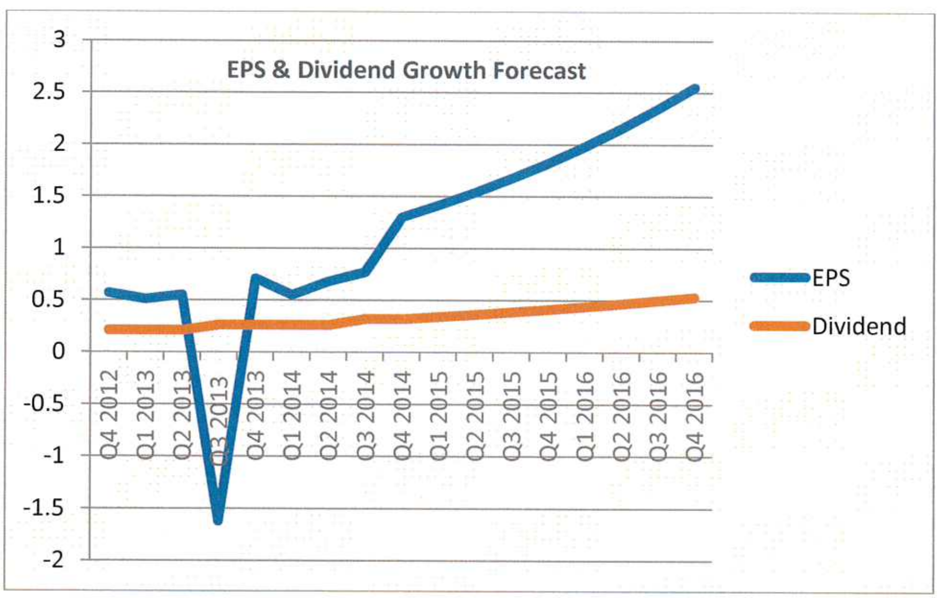
Historical Stock Performance

Dunkin Donuts has widely been viewed as Starbucks most worrisome competition since going public in 2011. Dunkin poses a threat with its low-cost brand popularity, and the rapid expansion throughout the Western United States. This hasn't seemed to pose a problem for Starbucks' stock price though. The stock has enjoyed large gains over the past four years, more than doubling that of its competitor with a return of 149%.



Earnings & Future Performance

As Starbucks continues to expand its product lines and grow in emerging markets, its revenue growth has been impressive. Revenues have grown over the past three years from 3.2 billion to 4.8 billion, averaging 14.5% per year. These high growth numbers have helped fuel the stock price, as investors look towards more growth in the future. Starbucks board of directors plans for 1,650 net new stores through 2015, with half of that growth coming from China/Asia Pacific, and the other half of that growth in the Americas. This, along with incremental growth from same-store sales is expected to produce revenue gains of 16%-18% in 2015. Operating Margin in 2015 is expected to slightly decline primarily due to the buyout and transition of Starbucks Japan from a joint venture to a corporate run entity. EPS and Dividends have consistently risen in the past, and are forecast by the board to continue into the future.



Cash Flows & Valuation Using Dividend Discount Model

	(In Millions)									
	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Year	1	2	3	4	5	6	7	8	9	10
Prior Year Cash Flow	$ 2,068.10	$ 2,336.95	$ 2,605.70	$ 2,866.27	$ 3,109.91	$ 3,327.60	$ 3,510.62	$ 3,703.70	$ 3,907.40	$ 4,122.31
Growth Rate	13.0%	11.5%	10.0%	8.5%	7.0%	5.5%	5.5%	5.5%	5.5%	5.5%
Cash Flow	$ 2,336.95	$ 2,605.70	$ 2,866.27	$ 3,109.91	$ 3,327.60	$ 3,510.62	$ 3,703.70	$ 3,907.40	$ 4,122.31	$ 4,349.04
Discount Rate	0.918526683	0.843691268	0.774952942	0.711814955	0.65382103	0.600552062	0.551623094	0.506680531	0.465399587	0.427481939
Discounted Value	$ 2,146.55	$ 2,198.41	$ 2,221.23	$ 2,213.68	$ 2,175.65	$ 2,108.31	$ 2,043.05	$ 1,979.81	$ 1,918.52	$ 1,859.14
Sum of Present Value of Cash Flows			$20,864.34							
Residual Value										
Cash Flow in year 10		$ 4,349.04								
Growth rate (g) (Nominal Past 10 years)		26%								
Cash Flow in year 11		$ 5,479.79								
Capitalization rate (k-g)		4%								
Value at end of year 10		$136,994.74								
Discount factor at end of year 10		0.427481939								
Present Value of Residual			$ 58,562.78							
(Intrinsic) Market Value of Company			$ 79,427.12							
(Intrinsic) Market Value per Share			**$ 105.90**							
Discount Rate (CAPM with E(rM) = 9)	8.9%									
Number of Shares	750									

Concluding Thought

While it's expected that each price forecast made by an analyst isn't going to match, any price difference signals that there is some fundamental difference in the calculations producing the price between one, or all of the investors in the market. My valuation of Starbucks at $105.90, places the company undervalued by about 9%. This is due to Starbucks (near) extreme growth numbers in sales, net income, EPS, and dividends. The value I'm placing in the company comes in the forecasts of strong future growth. I have full faith in an efficient market, but there are still gains to be made in this stock with the amount of growth that is expected in its namesake brand and foreign operations. We'll conclude by viewing some opinions from other analysts.

Recommendation Trends	Current Month	Last Month	Two Months Ago	Three Months Ago
Strong Buy	12	13	14	15
Buy	7	7	8	8
Hold	6	5	6	4
Underperform	1	1	0	0
Sell	0	0	0	0

Data provided by Thomson/First Call

Resources

Daily Finance - http://www.dailyfinance.com/?dailyfinancelogo
http://www.dailyfinance.com/quote/nasdaq/starbucks/sbux/earnings-growth-rates

Essentials of Investments - Ninth Edition, Bodie Kane Marcus, 2013

Google Finance - https://www.google.com/finance
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