PRINCIPLES OF FINANCE

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University of Arizona: Global Campus

BUS401: Principles of Finance

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**Dividends Analysis**

Table

International Business Machine Corp. (IBM) dividend history for the last ten years

Calculation of annual dividends growth rate

Dividends growth rate (g) = (D2/D1)-1

|  |  |  |  |
| --- | --- | --- | --- |
| Year | Dividend Amount | Dividend Yield | G- (D2/D1)-1 |
| 2020 | $1.63 | 5.60% | 0.0061728 |
| 2019 | $1.62 | 4.70% | 0.0318471 |
| 2018 | $1.57 | 5.10% | 0.0466667 |
| 2017 | $1.50 | 4% | 0.0714286 |
| 2016 | $1.40 | 3.60% | 0.2727273 |
| 2015 | $1.10 | 3.80% | 0 |
| 2014 | $1.10 | 2.70% | 0.1578947 |
| 2013 | $0.95 | 2.10% | 0.1176471 |
| 2012 | $0.85 | 1.60% | 0.1333333 |
| 2011 | $0.75 | 2.50% | 0.0714286 |

For instance, in 2020, g – (1.63/1.62)- 1= 0.0061728

**Calculation of average dividend growth**

For the most recent ten years

|  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Y | 2020 | 2019 | 2018 | 2017 | 2016 | 2015 | 2014 | 2013 | 2012 | 2011 | Total | Mean |
| G | 0.00617 | 0.03185 | 0.04667 | 0.07143 | 0.27273 | 0.0 | 0.15789 | 0.11765 | 0.13333 | 0.07143 | 0.909146 | 0.090915 |

The most recent 5 years

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| Y | 2020 | 2019 | 2018 | 2017 | 2016 | Total | Average |
| G | 0.00617 | 0.03185 | 0.04667 | 0.07143 | 0.27273 | 0.428843 | 0.085769 |

The most recent three years

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Y | 2020 | 2019 | 2018 | Total | Average |
| G | 0.00617 | 0.03185 | 0.04667 | 0.084687 | 0.028229 |

**Trends in the growth of dividends**

IBM can use dividends to determine the amount of net income earned by its shareholders during the year (Ammar, 2020). The company can use the dividend trends to determine whether it is financially stable or it is performing well. The company stakeholders should keep in mind that when the dividends payout ratio is high, more investors will get attracted to the company, hence increasing its value of the stock. From the tables above, we can establish the trends of dividends paid by IBM in terms of dollars, dividends growth rate, and even dividends yield.

In the recent ten years, IBM has managed to record a constant increase in its ability to pay dividends to its shareholders. From the table, we can tell that in 2011, the company paid out the lowest dividends to its shareholder ($0.75), increasing in the adjacent years. At a point like this, we can tell that the company was making lower profits or returns, which made them pay their shareholders lower amounts of dividends. Lower dividends for the company may scare away other potential investors, hence lowering the company's stock value. However, the dividends increased contently up to $1.63 per share (2020), showing that the IBM company progress was good. An increase in the number of dividends paid shows that the company was progressing well. This can result in an increase in the value of the share of IBM on the stock market. Furthermore, more investors will opt to invest with IBM because they will expect better returns when invested with IBM. Focusing on the dividends growth, the company had the highest growth rate in 2016, which was at 0.272. This shows that the company had increased its investment territories by increasing the number of its shareholders. However, in 2015, the growth rate was zero since the company did not increase its dividends paid to its shareholders.

Furthermore, trends in the averages for the recent 3years, 5years, and ten years can form a good basis for analysis. The average growth rate for the past ten years is 0.09, for the past five years, 0.08, and for the past three years, 0.02. This clearly shows that the company had a slower growth rate in the recent past three years. Therefore, IBM must consider using the average growth rate for the last ten years when making their forecast because it had the highest growth rate. Good trends in the dividends growth of IBM can be connected with the financial ratios of the company to show its financial stability. EBITDA Margin is one of the most valuable profitability ratios that can be used to determine the company's financial stability. For instance, in 2017, 2018, and 2019, the ratios were 49.49, 23.09, and 7.19, respectively. Therefore, the recent increase in dividends is accompanied by the trends in the EBITDA ratio, hence suggesting that the financial stability of IBM is good. Moreover, based on the income statements for 2018 and 2019, the dividends per share increased from 6.21 to 6.43, and this is a clear indication that IBM Corp. is stable financially.

**Preliminary Valuation**

Calculate the stock price for IBM company using constant growth formula

Stock price (P)= D/(r-g)

With low-end dividends

The stock price for IBM company can be calculated on the basis of a small-cap company. Therefore, r= 15%. Therefore, the stock price for IBM Corp. will be as follows.

D= 1.63, r=15% and g= 0.00617

= 1.63/ (0.15-0.00617)

= 113. 3282

Using High end dividends

D= 1.63, r=10% and G= 0.00617

=1.63/ (0.10-0.00617)

=173.7184

The stock price of a company refers to the current price that a share of stock is trading for on the market. The piece of the stock keeps on fluctuating following the law of demand and supply in the capital market (Sim, 2017). Therefore, the calculated stock price for IBM company using the lower end growth in dividends is at $ 113.3282. On the other hand, using the high-end dividends, the stock price for IBM will be at 173.7184. The company should note that having a higher stock price value is accompanied by risks. That is, in finance, the risk volatility rate increases with the increase in the value of the stock and its returns. Investors should choose between venturing into a risky investment for them to get high expected returns or less risky investments, which will earn them fewer returns.

The stock market price of IBM is 121.81 based on the Nasdaq stock price index. A comparison between the lower-end dividends’ stock price and the IBM market price on Nasdaq shows that the market stock price is higher. At such a point, investors will be buying the shares of the company cheaply. This will make the company make losses in terms of its shares because it will be selling its shares almost $8 lower than the market price. However, the investors who purchased IBM shares at $113.382 will gain at the current market price which is at 121.81 US dollars. However, investors who bought IBM shares at 173.7184 will go at a loss based on the shares' current market price.

Concussively, the company should calculate its stock price using a low-end dividend. This will make IBM not overvalue its stock than the market price, which can expose it to losses. The financial stability of IBM can be determined by its financial ratios. For instance, instance, the return on investment for IBM from 2017 to 2019 was 16.56, 19.2, and 13,52, respectively. Therefore, this means that IBM should rely on the stock price, which will make it get revived in terms of financial stability. The low-end dividend calculation will imply that the shares of the company have fewer risks, hence attracting more investors. Arguably, using the book value per share ratios, we can find that the ratios for IBM company from 2017-2019 were 19.08, 18.82, and 23.49, respectively. It will be more profitable for IBM Corp if it considers valuing its shares using a low-end dividend policy. This will expose it to a lower risk rate despite making minimal returns on the assets.

References

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