



Universidad de
SanAndrés

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Department of Economics
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Starbucks Corporation Valuation

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1. Abstract

The objective of this work was to estimate the equity market value of Starbucks Corporation. To do so, I used two different valuation methods, discounted cash flow and multiple valuation. By doing so, I was able to obtain two separate equity values, which enabled me provide to provide a range of value for the company, rather than a specific single value. Some general context with respects to the economy and the industry was provided to support and guide future projections of certain key variables for the businesses.

After performing the valuation analysis with both methodologies, Starbucks value was estimated to be in the range of \$93 to \$96 billion. A sensitivity analysis was later performed over some key variables to the business. Equity value was very sensitive and varied considerably with small changes over GDP or inflation projections, as well as discount rates.



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2. Introduction

Equity valuation “refers to the process of determining the fair market value of equity securities” (“Equity Valuation: Definition,” n.d., para. 4). It enables the investor to recognize on which grounds a business currently stands on and allows it to fully understand the state of a company, how it works and where it is going to be in the future. Stakeholders, mainly shareholders, are interested in knowing the value of the enterprises they invest in. If this method is properly applied, they can ensure themselves that the value estimate they get reflects a fair value of their firm. Based upon this result they can decide which course of action they are going to take in the future.

Starbucks Corporation is the market leader in the coffee retail industry. With more than 25.000 thousand stores in 75 countries around the world and employing approximately 254.000 people it generated revenue of 21.3 billion dollars in 2016 (Annual Report, 2016). Starbucks is a central player in this particular industry and hundreds of thousands of people depend on it.

The goal of this paper is to determine an estimate of the fair value of Starbucks Co.’s, taking into consideration its potential new sources of growth, updating the information used and incorporating different methods for the valuation process.

This work will be structured from a macro to micro point of view. Working down from the most general, economic and industry data, to the more specific, company related information. In section three, I will analyze the macroeconomic environment. I assess the global economic state and pay special attention to the most significant countries for Starbucks’ operations. I will specify future prospects in order to establish some grounds for analysis. In this same chapter, I will study the industry and I will make a brief mention on its recent history. I will describe the structure and its barriers to entry in order to gain proper knowledge on how the industry works. After that, I will detail the future perspectives in order to provide the base for what can be expected of this industry hereafter. In section four, I will focus on the company itself and make a comprehensive research to thoroughly understand it’s functioning. Sections 5 and 6 are directly related to the valuation of Starbucks Corporation. In section five, I will define and explain the valuation methods and the theory related to them. In section 6, I will perform the valuation

and I will estimate of the company and perform a sensitivity analysis in which the value of the company is determined based upon different outcomes for certain variables. The last three sections correspond to the Conclusion, Appendix and References.



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3. Economic Context & Industry Analysis

3.1 Economic Context

The consumer discretionary sector relies on an overall healthy economy in order for consumers have higher levels of disposable income to spend on non-essential products. That being said, the global economy has been experiencing instability and turmoil since the global financial crisis in 2008. Stalling global trade, weak investments and policy uncertainty have debilitated global growth in the past years (Global Economic Prospects, 2017). The average growth rate of the decade leading to the financial crisis in 2008 was of 3.4%, but the growth rate for 2016 was of 2.3% (Oxford Economics). This figure is still far from the post-crisis growth rates. The growth forecast for 2017, is of 2.7%. This growth will be primarily due to the recovery experienced in emerging markets and developing economies across the globe (Global Economic Prospects, 2017). Inflation levels are expected to increase at an average rate of 2.8% for the next ten years.

The U.S. economy is Starbucks' biggest market and the company relies heavily on it to generate its main sales income. The United States economy achieved a growth rate of 1.6% during 2016 and is expected to reach a 2.1% during 2017. Following the presidential elections in November, macroeconomic projections for the US have become more uncertain. Various proposals for changes in tax legislation, infrastructure spending, immigration and trade have created doubt with respect to the country's economic future. Inflation, measured through the consumer price index, stood at 1.3% for 2016. Inflation is expected to increase for 2017, up to 2.6% , nonetheless the forecast for the following years it estimated to be of only 2%. Unemployment is expected to fall 6% in 2017, down to 7.2 million people. Unemployment has fallen considerably since the 2008 crisis where the number of unemployed reached 15.3 million people. Average household disposable income has risen 2% in 2016, is expected to continue increasing at 1% a year after 2017. With the decrease in unemployment rates and average household disposable income rising constantly, discretionary purchases can be expected to continue improving in the future.

The Eurozone comprises important markets for Starbucks Corporation's presence overseas as well as future expected expansion possibilities. The European Union saw its real GDP grow 1.9% during 2016. The economy of the 19 countries

that use the euro fell 0.4% with respect to 2015 growth. Although the EU is achieving healthier levels of growth after many years, which is a good indicator of the direction in which the economy is heading, eight years have passed since the crisis exploded and there are still some countries struggling to show signs of improvement in their local economies. The “Eurozone jobless rate, while edging down slightly, remained above 10%” (Goodman, 2016) with economies that have recovered substantially, such as Germany and the Netherlands, and with others who are still fighting to do so, like Greece, Italy and Cyprus (Goodman, 2016).

The Chinese market is the most important for Starbucks’ expansion activities abroad, where substantial resources are being invested to maximize the incremental levels of revenues one of the biggest markets abroad has to offer. China’s economy is forecasted to grow by 6.6 percent in 2017, having achieved similar levels of growth during 2016. Nevertheless, some recent economic data showed that “credit growth, industrial production, retail sales and fixed-asset investment data fell short of expectations reigniting fears the presumed recent stabilization in the Chinese economy may be short-lived” (Tomlinson, 2016). A Chinese slowdown will directly impact the world’s economy chances of fully recovering, because of how certain economies depend on it. For example, the European Union depends heavily on China’s growth because it is its “second-largest trading partner behind the United States” (Goodman, 2016) and has played a key role on Europe’s exports growth, which have aided considerably on its recovery (Goodman, 2016). Chinese inflation reached 2% at the end of 2016 and will reach 2.4% in 2017. Consumer spending in non-alcoholic beverages and food has increase in the last four years at an average of 3% and 5% respectively. At the same time the level of households of middle income classes are increasing. Households in the income bands between \$20.000-\$35.000, \$35.000-70.000 and \$70.000-\$100.000 have grown at average rates of 7%, 10% and 12% respectively. This customer growing customer base is what Starbucks intends to benefit from by expanding Asia, more specifically China.

The global economy is in a delicate state. It is still recovering from the global financial crisis of 2008 and despite some improvement and favorable data it has lagging countries and regions that still could not fully rebound from it. On top of that, some key economies such as the U.S. and China still need to show signs of permanent

growth and stability to reduce uncertainty and speculation based on their economic conditions.

3.2 Industry Analysis & Perspectives

3.2.1 Industry

The consumer discretionary sector is defined as “the sector of the economy that consists of businesses that sell nonessential goods and services” (“Consumer Discretionary”, n.d., para. 1). Various firms from different industries compose this sector. There are retailers, specialty retail, consumer services, hotels, restaurants and leisure amongst others. Starbucks and its main competitors all reside in the Hotels, Restaurants & Leisure industry. Due to its nature, this sector generally performs better when the economy is in a good state. “Demand is driven by a fairly consistent group of factors throughout the whole industry: personal income levels, total employment and consumer confidence” (The Street Ratings, 2016). It is the opposite of the consumer staples sector, which sells goods and services that are necessities. One of the first things consumers cut back on when the economy slows down and unemployment rises, are non-essential discretionary purchases. Crises or even the economic cycle might severely affect this sector. “In recent years, catastrophic weather, fear of terrorism and health epidemics directly impacted the industry in a material way” (The Street Ratings, 2016). The housing bubble crisis considerably damaged the sector and made it fall to historical lows. As the US economy picked up, the sector recovered and grew to new highs.

The S&P 500 Consumer Discretionary Index is composed of the S&P 500 companies classified as members of the Global Industry Classification Standard consumer discretionary sector. Amongst this list of companies, we can find Starbucks, as well as a main competitor such as McDonald's. As we can see in the



Figure 1: S&P 500 Consumer Discretionary Performance 2007-2017, S&P Dow Jones Indices

graph above, the Index reached its lowest levels between 2008 and 2009 when the subprime mortgage crisis was at its deepest point.

The foodservice industry is known for being personnel intensive amongst other factors (The Street Ratings, 2016). It is expected to employ 14.4 million people in the United States by the end of 2016, making it the second largest employer behind the U.S. government. Expected sales for this year are estimated at \$782.7 billion (National Restaurant Association, 2016).

3.2.2 Entry Barriers

Most of the main players in the industry are well known locally and internationally. These are often very large, international firms that have developed a strong brand name and presence in the markets they operate. Despite their scale and size, “nonexistent switching costs, intense industry competition and low barriers to entry make it very difficult for retailers to establish an economic moat” (Morningstar, 2010). An economic moat refers to a “business ‘ability to maintain competitive advantages over its competitors in order to protect its long-term profits and market share from competing firms” (Gallant, n.d., para. 1). The wider the economic moat, the higher the probability that a certain firm will maintain the advantage it has over its competitors.

This is an extremely competitive industry where each firm is constantly innovating to gain market share away from its competitors, through a variety of different channels. That is why with “the entrance of new players, the level of competition is expected to further intensify in the near future” (GlobalData, 2016).

There has been a development of various small firms that compete at a local level offering products and services in the same category as these large enterprises. These businesses operate at a considerably smaller scale with certain differentiation strategies such as different production methods and types of products, lower prices, and premium service (Fauria, 2016). By doing so, they are able to target a narrower market segment and sell their products to a more specific and smaller clientele.

3.2.3 Trends

The industry is in a phase of growth and expansion. The restaurant business in the United States expects to generate \$782.7 billion dollars in 2016 and have an employment base of 16.1 million people by 2026 (National Restaurant Association, 2016). Innovation is part of the evolution process and firms are increasingly employing “mobile technology and social media as customer service and marketing tools” (Langford, 2016). They are using these platforms to promote new products or services, as well as a more direct way of getting in touch with customers (Langford, 2016). Based on the consumer trends for 2016 of the National Restaurant Association, 72% of consumers say that restaurant technology increases convenience and 39% of smartphone users would pay restaurant tabs via smartphone app if offered (National Restaurant Association, 2016). Technology is taking on a more important role globally and in this industry. Firms should know how to adapt to the changing scenarios and take advantage of the different opportunities these new developments present. There is a lot of growth potential if done effectively.

Managing employees properly and being able to “empower and engage them across all strategic pain points” (Langford, 2016) will prove to be a great source of potential growth for the future. Retaining employees and building long lasting relationships will have a positive impact on the firm’s performance. To do so, they have to “train and incentivize them to make independent decisions. Hold them accountable and reward them for the results of their decisions” (Langford, 2016).

Nonetheless, there are some risks that threaten the performance of the industry. Oil prices can be seen as a double-edged sword because “a sustained period of “low oil” is often viewed as a deflationary sign of a global economic slowdown” (Langford, 2016). This situation would severely affect these types of businesses, but at the same time, it reduces household spending on gas leaving more income available for other activities, such as traveling and dining out (Langford, 2016). Terrorist threats and attacks can be detrimental for customer visits to restaurants and hotels, as fear of being in danger would lead to avoiding public and popular places (Langford, 2016). Labor costs and regulations are always a concern in such an employee intensive industry. “The call for a \$15 national minimum wage appears to be gaining traction” (Langford, 2016) Firms heavily rely on workers for the proper functioning of their business therefore their profits could be hurt if wages were to rise considerably.



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4. Starbucks

4.1 Brief History

Starbucks was founded in 1971 by Gordon Bowker, Jerry Baldwin and Zey Siegl in Seattle, Washington. In the beginnings, the company had only one store from which it sold coffee grains. In 1982, Howard Schultz joined the company as the director of retail operations and marketing. After traveling to Italy, Schultz was captivated by the coffeehouses in Milan and convinced the owners to test out the idea in Seattle, which turned out to be a success. In 1985, the now former director, Howard Schultz, founded Il Giornale a firm that sold brewed coffee and espresso beverages, made with Starbucks products. Two years later, he acquired Starbucks from the original owners and changed the name to Starbucks Corporation (Starbucks Company Timeline, n.d.). This was the first step in creating the coffeehouse giant we have today. In the present, Starbucks is “the premier roaster, marketer and retailer of specialty coffee in the world”, with over 25,000 stores in 75 countries. The company purchases and roasts high quality coffee together with handcrafted coffee and other types of beverages such as tea and juices. They also offer a variety of fresh food items and pastries. Starbucks also sells goods and services under other brands such as Teavana, Tazo, Seattle’s Best Coffee, Evolution Fresh, La Boulange and Ethos (Starbucks Corporation, 2016).

4.2 Strategy

Starbucks’ strategy stands on three legs (Moon & Quelch, 2004). First, it intends to offer the best quality Arabica and green coffee from Africa, Central and South America and from the Asian Pacific (Moon & Quelch, 2004). To do so, the company is present all along the production chain. It works together with the farmers who grow the coffee beans, then carefully roasts the grains to the desired state and personally sells its products through its company operated and licensed stores (Moon & Quelch, 2004). On second place, the customer service takes on a central role. The interactions with the clients are referred to as “the intimacy with the client” (Moon & Quelch, 2004). The baristas are expected to deliver a cordial service and as personalized as possible. Thirdly, each store intends to create a warm and welcoming ambiance where people can gather and enjoy themselves. They are “designed to reflect the unique character of each neighborhood” they serve and are

developed through sustainable building practices as well as being clean and well maintained (Starbucks Corporation, 2016). By doing so, the firm ensures it delivers a proper “Starbucks Experience” and establishes its stores, as the “third place” besides home and work for its customers (Moon & Quelch, 2004). This strategy provides the adequate vehicle to achieve its mission statement, which is: “To inspire and nurture the human spirit – one person, one cup and one neighborhood at a time” (Our Mission, n.d.) and at the same time it provides a strong differentiation from its competitors.

This strategy is further intensified through the wide economic moat “based on a brand intangible asset that commands premium pricing and meaningful scale advantages” (Hottovy, 2015). This whole strategy has allowed the firm to attain a high level of differentiation and it will enable the firm to “maintain its specialty coffee leadership and successfully penetrate new growth avenues” in the future. (Hottovy, 2015).

4.3 Products

Starbucks offers a variety of drinks, such as: espresso beverages, freshly brewed coffee, chocolate beverages, bottled drinks, iced coffee and tea, smoothies, kids’ drinks and trademarked and registered products, Frappuccino Blended Beverages, Starbucks Refreshers Beverages, Evolution Fresh juices and Fizzio Handcrafted Sodas (Starbucks Drinks, n.d.).

Additionally, there is also a food menu composed of bakery products, Starbucks Petites (small chocolate treats), Bistro Boxes (ready to eat small meals), Hot Breakfast options, sandwiches, panini, salads, yoghurt pots and fresh fruit (Starbucks Food, n.d.).

Lastly you can get coffee related products and equipment for home consumption, such as whole bean and grain coffee from different locations across the globe together with its Reserve Coffee, Verismo and Starbucks K-Cup pods, Starbucks VIA instant coffee and portion packs, mugs, Verismo Machines, coffee presses, coffee makers, grinders and teapots.

Retail Sales mix by product type

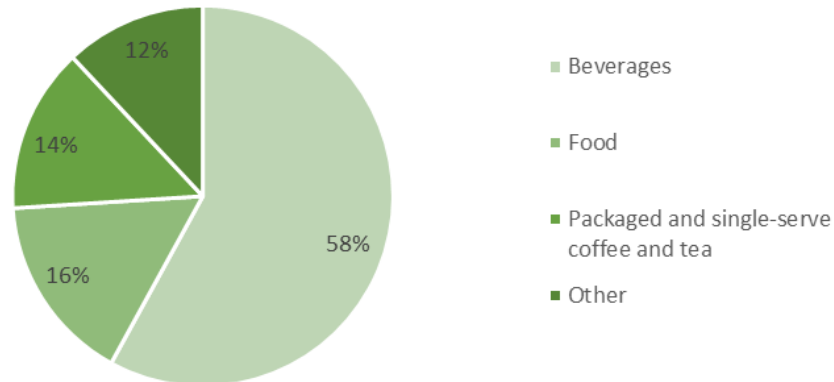


Figure 2: Starbucks Retail Sales Mix by Product Type, 2016 Annual Report

Beverages represent the majority of sales by product type with a 58%, followed in second place by food sales with a considerably lower 16%. Beverages have represented the same percentage of total sales for the past three years.

Consolidated revenue mix by product type

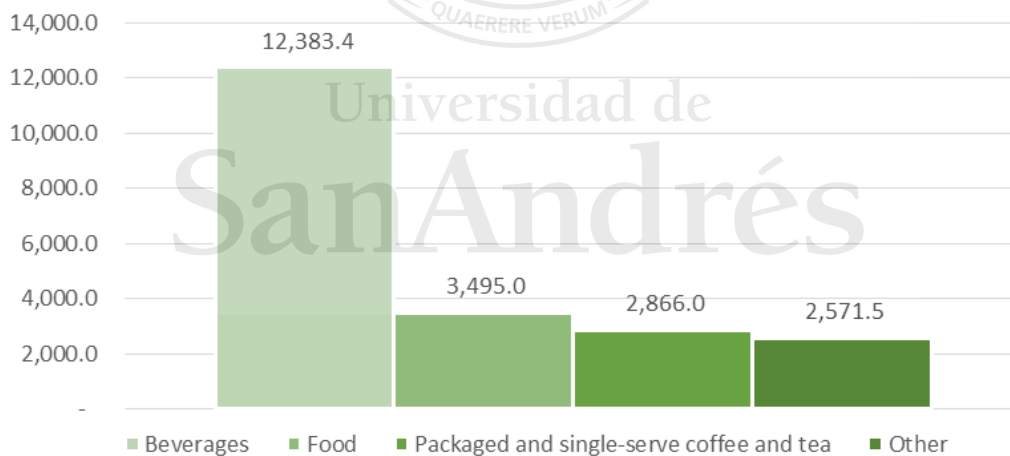


Figure 3: Consolidated revenue mix by product type, 2016 Annual Report

The 58% that beverages sales represent amount up to a little over 12 billion dollars in sales. Starbucks relies heavily on the sale of beverages to generate the core of its revenue given that Food, being the second most profitable product sold by the company, generates almost \$3.5 billion in sales.

4.4 Markets & Store Formats

Starbucks is present in 75 countries worldwide and has plans of expanding even more in the following years. Its business is divided into four reportable operating segments and several non-reportable operating segments. The segments are Americas, China and Asia Pacific (CAP), Europe, Middle East and Africa (EMEA), a Channel Development sector and All Other Segments, where the non-reportable operating segments are

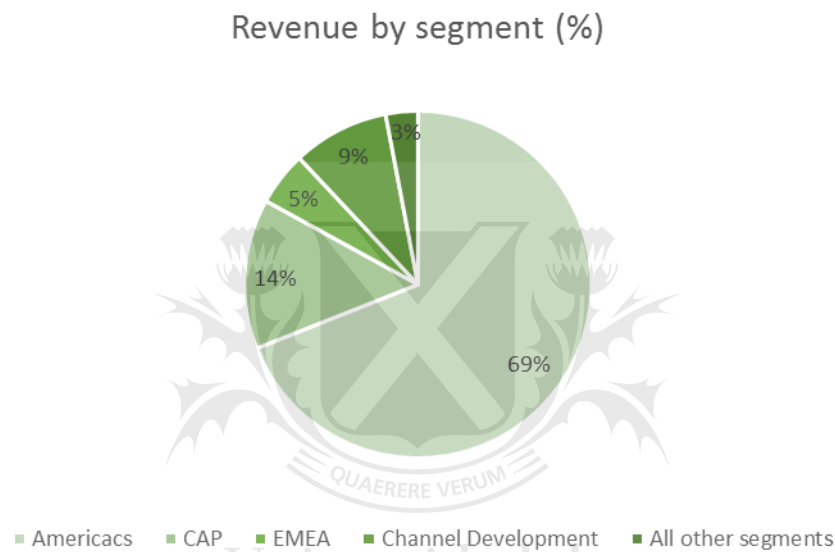


Figure 4: Revenue Percentage by Segment for Starbucks 2016, 2016 Annual Report

considered jointly (Starbucks Corporation, 2016). The non-reportable segments include the results of other brands such as Teavana, Seattle’s Best Coffee, Evolution Fresh, Digital Venture business and some developing businesses such as Starbucks Reserve Roastery & Tasting Room.

The Americas, CAP and EMEA segments include licensed and company operated stores. “Most licensees are prominent retailers with in-depth market knowledge and access” (Starbucks Corporation, 2016). They tend to “have a lower gross margin and a higher operating margin than company-operated stores” (Starbucks Corporation, 2016). “Starbucks receives a reduced share of the total store revenues” (Starbucks Corporation, 2016), however this is offset by the shrinkage in costs that are mostly incurred by the licensee (Starbucks Corporation, 2016). Starbucks fully manages and funds company operated stores. They tend to be “located in high-traffic, high-visibility locations” (Starbucks Corporation, 2016).

“Retail landlords often grant Starbucks exclusive leases to prominent locations rife with consumer traffic” (Hottovy, 2015) making it on of the few companies with access to this kind of real estate. Starbucks intends on further expanding its various “store formats, including Drive Thru and express stores, to provide a greater degree of access and convenience” (Starbuck Corporation, 2016) for its customers.

Specific markets within CAP and EMEA are still in a development phase and have higher costs of doing business. “Occupancy costs and store operating expenses can be higher internationally than in the U.S. due to higher rent for prime store locations or costs of compliance with country-specific regulatory requirements” (Starbuck Corporation, 2016).



Figure 5: Number of Starbucks locations by sector 2016, Annual Report

There is a total amount of 12.711 company-operated stores worldwide and 12.374 licensed. The number of stores, licensed and company-operated, is quite similar, but the total amount of stores in each segment is not. There are 15.607 stores in the Americas sector, with United States as a leader with as much as 13.172, followed in second place by Canada with 1.399 stores. The second and third biggest segments are the CAP and EMEA with a total of 6.443 and 2.642 locations respectively. In those particular segments, China has the lead with 2.382 stores and the UK with 898 (Starbucks Corporation, 2016).

Revenue Components (%)

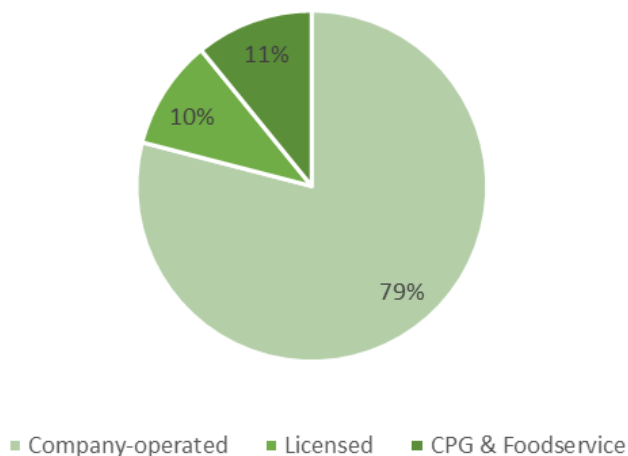


Figure 6: Revenue Components by Business Segment 2016, 2016 Annual Report

The company also depends mainly on the performance of the company-operated stores, which generate 79% of the annual revenues. Although there is only a difference of 1.427 stores between company-operated and licensed, the revenue structure of each one delivers substantially dissimilar results. It is worth noting that the company-operated stores are located in bigger and more developed countries, such as United States, Canada, United Kingdom, China, Japan and Germany amongst others. In each of these countries, the Starbucks brand is well established with a strong demand for its products or is growing considerably such as in the case of China where the amount of stores has grown 32% from 2015 to 2016. The amount and type of countries where company-operated and licensed stores are located varies considerably. On top of that, many of these stores tend to receive more customer visits due to their size and location. Starbucks generally has direct control over the most important stores in terms of size and location.

4.5 Income

This section is based entirely on the information provided in Starbucks Corporation 2016 Annual Report.

Starbucks had revenue of \$21.3 billion in fiscal 2016. This represented an 11,2% increase from the result obtained in 2015. Revenues have been increasing consistently since 2003, with the exception of a minor dip in 2009 that saw revenue fall from \$10.4 billion in 2008 to \$9.8 billion.

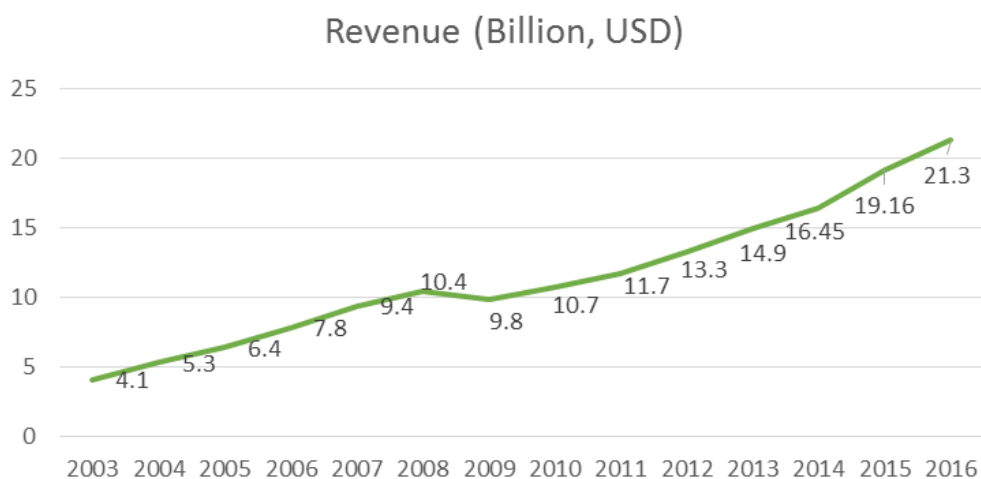


Figure 7: Yearly revenue for Starbucks Corporation, 2016 Annual Report

The bulk of the revenue comes from the Americas segment, with a total of \$14.795,4 billion. This represented an increase of 11,3% from the results in 2015. It was driven mainly by an increase in revenues of company-operated stores of \$1.3 billion (incremental revenues from 348 new stores and an increase in comparable store sales) and licensed stores of \$184 million (incremental royalties from 456 new stores and higher product sales).

The whole company is heavily dependent on the Americas division from which it draws the main share of its revenue. This is where the company has been operating for the longest time and thus it is the most mature sector with the largest scale. At the same time, due to the characteristics mentioned above it has lower expected growth rates.

The CAP segment is the second biggest revenue sector delivering U\$2.938,8 billion. The growth here was of 23% from last year's result, mainly driven by company-operated store sales which contributed an increase of \$513 million, directly linked to the opening of 359 new stores and the incremental result from the change of ownership from Starbucks Japan stores. The company transferred 1.009 Japan stores from licensed to company-operated in the first quarter of fiscal year 2015.

The EMEA division saw its revenue decline by 9% to \$1.124,9 billion. This \$92 million fall in revenues from 2015 was caused by a shift to more licensed stores

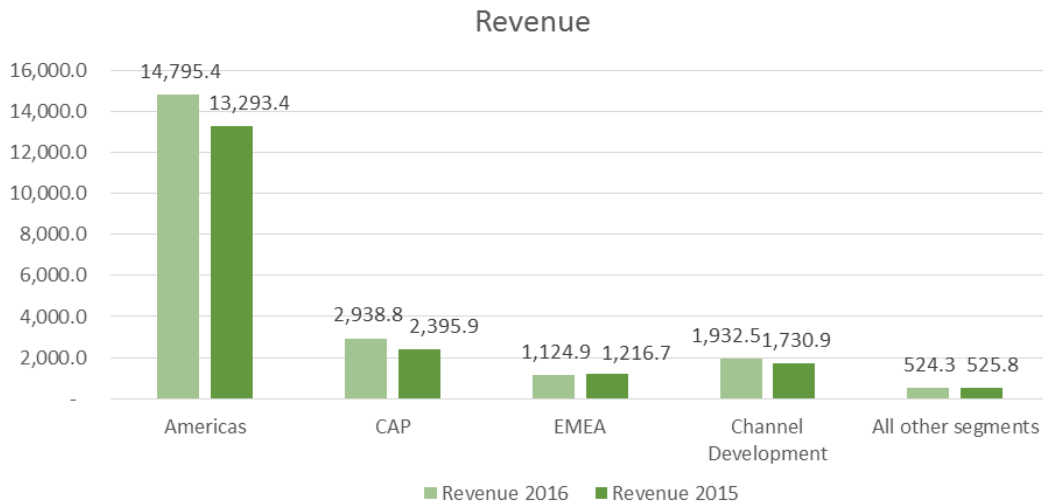


Figure 8: Revenue comparison for each reporting sector, 2016 Annual Report

in the region, which lead to a fall in company-operated stores revenues. This change in store ownership took place mainly in Germany, where the company transferred 147 company-operated stores to licensed stores. Licensed store revenues did increase by as much as 32% due to an increase in the royalties from this type of stores.

The Channel Development sector was the third best performing, with a result of U\$1.932,5 million. This 12% increase from 2015 was mainly due to the greater sales of single-serve premium products, such as Starbucks and Tazo K-Cup portion packs as well as packaged coffee and foodservice.

Finally, the All Other Segments division had a slight decrease in its performance. Its total net revenues fell by \$1.5 million to \$524,3. This segment is composed of Teavana, Starbucks Reserve Roastery & Tasting Room and Evolution Fresh. This sector has the least amount of stores with 393 worldwide, located in the United States, Canada, Mexico and certain countries in the Middle East.

4.6 Competitors

Starbucks is the biggest coffee house retailer in the world and thus, it faces intense competition in all areas of business both from local and international companies. This happens through various channels such as “product quality, innovation, service, convenience and price” (Starbucks Corporation, 2016). Due to its leading role and reputation in the market, many small coffee chains together with

large firms in the consumer discretionary sector, have emerged to offer high-quality coffee and/or similar business concepts.

Company Name	Market Capitalization MM	Revenue MM (LTM)	EBITDA	EV / EBITDA (NTM)	EV / Revenue (NTM)
Starbucks Corp	87,276.99	21,976.10	4,883.80	14.68	3.67
McDonald's Corp	117,541.27	24,393.90	9,310.70	14.29	6.70
Dunkin' Brands Group Inc	5,101.85	829.79	442.85	14.83	8.38
Panera Bread Co	7,111.04	2,837.85	403.19	15.99	2.42
Yum! Brands Inc	24,352.41	9,765.00	1,814.00	16.09	6.15
Cracker Barrel Old Country Store Inc	3,950.68	2,928.37	358.29	10.13	1.36
Chipotle Mexican Grill Inc	14,002.46	4,138.75	204.23	21.49	2.75
Whitbread PLC	9,707.33	3,886.35	988.68	9.56	2.42
Darden Restaurants Inc	10,969.16	7,025.80	922.00	10.54	1.47
Wendys Co	3,910.12	1,342.45	393.48	14.96	5.12
Domino's Pizza	7,666.20	2,216.50	434.50	21.07	4.13

Figure 9: Comparable companies metrics

The list of comparable companies used for this analysis together with some key metrics is presented above. Comparable companies for this analysis have been chosen taking into consideration a series of different factors, such as core business, company size, revenues, store count and international presence amongst others. Due to the nature of Starbucks' business, there were not many companies in the industry that gathered all of the conditions mentioned above. To work around this issue, the criteria to select the comparable companies had to be relaxed and adapted to the available companies in the market. The companies chosen have similar business concepts of franchisable nature, high market capitalizations and a considerable store count both in the US as well as globally. Whenever possible, companies that sell coffee or some type of beverage were selected. Not all companies have the same core business as Starbucks, but they all belong to the Hotels, Restaurants & Leisure industry.

Starbucks Corporation and McDonalds have the bigger portions of the market and they continue, “to capture market share at the expense of smaller rivals such as Dunkin’ Brands” (Sharma, 2016). Competition amongst these firms happens in all levels of business. Now various companies have placed more focus on the design of loyalty programs and mobile ordering platforms (Sharma, 2016). Dunkin’ Donuts developed its loyalty program and is hoping to “open up new opportunities for it to move in Starbucks territory” (Cansler, 2016), who recently made some changes to its own loyalty program. At the same time, McDonalds “is ready to launch its first full-fledged loyalty program later this year or early 2017” (Ryan, 2016). Firms have to be constantly adapting and reacting to what their competitors do in order to avoid losing market share. Starbucks also competes against large local businesses in markets outside the US. Such is the case in Canada and the UK, where Tim Hortons and Costa Coffee respectively, have a central position in the industry. Starbucks does “not have leadership positions in all channels and all markets” (Starbucks Corporation, 2016). According to a survey carried out by YouGov annual study, Costa Coffee is UK’s favorite brand of coffee shops over Starbucks and Caffè Nero (Whitbread PLC, 2015). Based upon a poll carried out by Tim Hortons, 8 out of every 10 cups of coffee poured in Canada are from Tim Hortons (“That Calls For Coffee.”, n.d., para. 4).

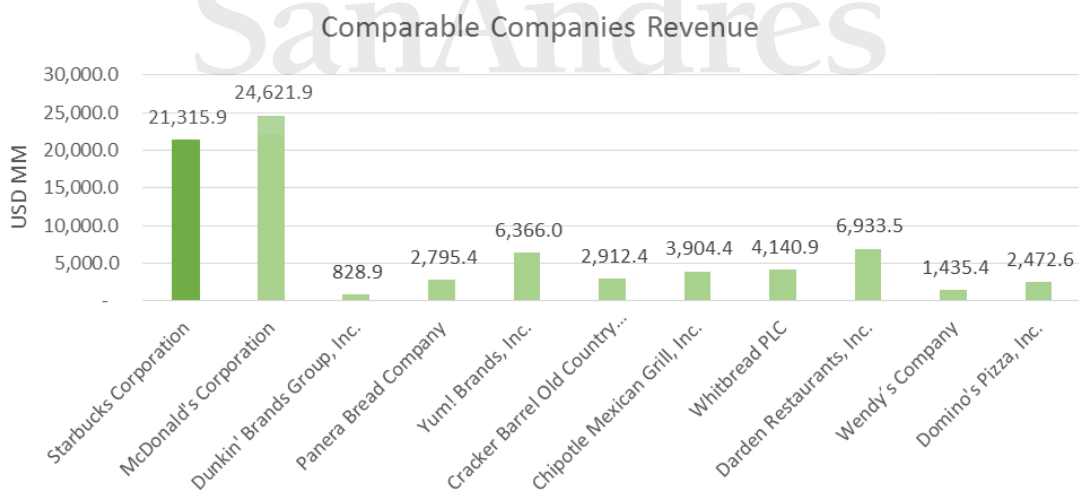


Figure 10: 2016 Annual Revenue for Starbucks and Comparable companies

McDonalds had revenue of U\$24,6 billion in 2016 (McDonald’s, 2016). This result, positions it at the top of the industry in terms of revenue. Nonetheless this is due to the performance of McDonald’s business as a whole, including its hamburger chain results and not only the McCafe division. Starbucks had lower revenue of U\$21,31 billion but unlike McDonalds this is directly related to the coffeehouse business. There is a considerable difference in revenues amongst the comparable companies. In third place, we can see Darden Restaurants with almost \$7 billion in sales.

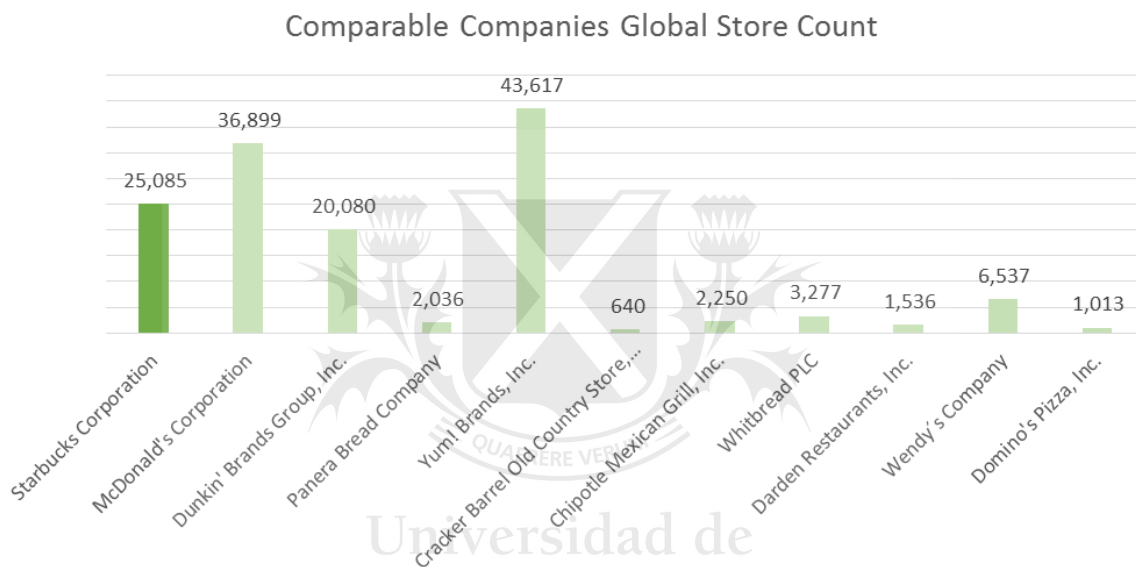


Figure 11: Number of Stores Worldwide 2016

Yum! Brands, which is comprised of Kentucky Fried Chicken, Pizza Hut and Taco Bell, stands at the top of the global store count with 43,617 locations. It is followed by McDonald’s with almost 37.000 and in third place we find Starbucks with a little over 25,000 stores.

In terms of core business, Whitbread’s Costa Coffee and Tim Hortons, part of Restaurant Brands International, are the most similar to Starbucks. They operate quick-service restaurants that offer coffee, tea, pastries and sandwiches. Both, Costa Coffee and Tim Hortons are the leaders in the UK and Canada, their respective home markets. On a global level, Starbucks holds a leading position both in terms of revenues and in terms of store count but faces intense competition in Canada and the UK where it has not positioned itself as a leader.

The differentiation strategies that companies possess are numerous, such as charging lower prices, offering different types of products or even specific developments that are not directly related to the core business, such as Loyalty Reward Programs or mobile ordering platforms.

There are many variables that come into play in the industry and Starbucks “must preserve, grow and leverage the value” (Starbucks Corporation, 2016) of its brand to maintain its global reputation and market position.

4.7 Perspectives

For 2017, Starbucks expects to see a revenue growth in the range of 8% to 10%, together with the expectation of 2,100 net new stores globally. (Starbucks Corporation Earnings Release Q1, 2017) Furthermore, as part of the 5-year strategic plan, the objective is to open 21,000 new stores globally and 3,400 net new stores in the US by 2021, reaching 37,000 stores worldwide. (Starbucks Corporation Earnings Release Q2, 2017).

There are expansion plans in place for the Starbucks Reserve Roastery & Tasting Room stores, which are already under design or construction in major cities around the world, such as Shanghai, New York, Tokyo, Milan and Chicago. Starbucks Reserve stores offer a different experience than normal stores. In these stores, customers can select different unroasted beans from different locations across the world, experience the roasting process, and have access to exclusive beans and other offerings such as exclusive merchandise and food products. The Shanghai store is expected for 2017, the New York, Milan and Tokyo stores for 2018 and the Chicago store for 2019.

The Italian market presents some challenges due to the strong and essentially different coffee culture that the country has. The company states that the future growth increasingly depends on the growth and sustained profitability of their CAP and EMEA operating segments (Starbucks Corporation, 2016). This is why it is also expanding its operations in China, where “the company plans to open 500 additional stores per year over the next five years” (Soper, 2016). By doing so it will expand its store base up to around 3.500 in the whole country by 2021. This represents the most aggressive expansion plan carried out by the firm. China provides an enormous clientele base. Schultz, the now former CEO of the company,

stated that the “key customers for Starbucks” (Soper, 2016) belong to the middle class in China, which “is expected to double from 300 million over the next six years” (Soper, 2016). To further capitalize on what the Chinese market has to offer, Starbucks together with Weixin, the leading mobile social communications service, launched “Say it with Starbucks” a online-to-offline social gifting innovation that enables users to gift Starbucks beverages or gift cards. (Starbucks Corporation Earnings Report Q2, 2017).

Starbucks introduced a change on its Loyalty Program Rewards in 2016. The program now awards two stars every \$1 spent by a customer, where previously each customer would receive one star per visit no matter how much he or she spent. The amount of money that is needed to obtain a free reward rose considerably to \$63 (or 125 stars). Prior to this, a customer could obtain one by visiting the store 12 times (12 stars, one per visit) and purchasing the cheapest item available each time. By doing so, the company is rewarding customers who spend more money and not those who visit the stores more often. This has created some resentment amongst customers who have expressed their discomfort through the social media (Vasel, 2016).

Together with this new Loyalty Program, Starbucks Mobile Order and Pay App, which was introduced in 2014, is delivering increasingly positive results. The system allows the customers to order and pay in advance from their phones and thus avoiding queuing. In its second quarter Financial Release for 2017, Starbucks reported that Mobile Payment reached 29% of transactions and Mobile Order & Pay grew to 8% of total transactions in the US. (Starbucks Investor Relations, 2017).

Another digital innovation, which is already available in a beta version for a small group of users, is My Starbucks Barista, which allows customers to order and pay in advance by using their voice. This is a new feature within the mobile app which is powered by artificial intelligence and intends to deliver the same experience as if the customer were talking to a barista in store (Starbucks Newsroom, 2017).

“Starbucks’ innovative mobile/digital/loyalty offerings, channel development efforts, geographic market expansion opportunities and its complementary brand portfolio” (Hottovy, 2015) provide the means for “average

annual revenue growth in the low double digits and cash flow growth in the mid- to high tens over the next decade” (Hottovy, 2015).

Starbucks buys its coffee using fixed-price and price-to-be-fixed purchase commitments to ensure an adequate coffee supply. Priced-to-be-fixed contracts are purchase commitments where the quantity, quality, delivery period and other negotiated terms are agreed upon, but the date and the price, which is based on the “C” coffee commodity price, has not been established. For most of the contracts either Starbucks or the seller has the possibility to fix the base “C” coffee commodity price prior to the delivery date. On other cases, Starbucks or the seller may agree upon the price parameters determined by the base “C” coffee commodity price. The fact is that, until either of these happen, the costs of coffee purchases are estimated by Starbucks. Total coffee commitments as of October 2nd 2016 totaled \$1.1 billion, which together with existing inventory worth \$561.6 million of unroasted coffee and \$300.4 million of roasted coffee, are expected to provide an adequate supply of coffee for fiscal 2017. (Starbucks Corporation, 2017)

The market for coffee might experience some turmoil in the following months or even years, related to some doubts about the level of global production and more specifically out of Brazil (Verdin, 2016). There is an “increasing concern that global supply will continue to shrink because of El Nino-induced crop losses in South America and Southeast Asia” (Perez, 2016). Furthermore, demand is rising considerably since more people are consuming coffee worldwide (Macro Investing, 2016). Nevertheless, some developments at the start with respects to coffee production have reduced the worries of scarcity and price increases in the future. Colombian Arabica coffee production increased 4.8% to 4.4 million bags, between January and April of 2017. The crop year (October-April) has seen Colombian coffee production rise 5.4% so far (Global Coffee Report, 2017). At the same time, Vietnam, the second largest producer of coffee in the world behind Brazil, is forecasted to harvest 28.6 million bags of coffee during 2017-2018. This amount represents an increase of 10% from the current harvested amount. These developments have changed the outlook of last year and support a scenario of stable global supply for the next years. (VN Express, 2017).

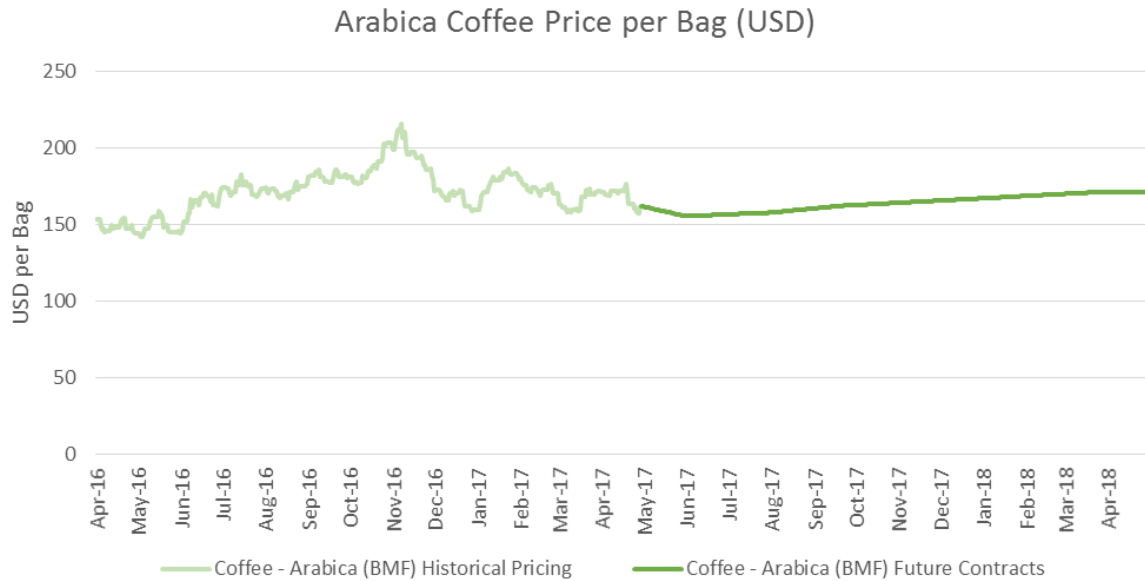


Figure 12: Arabica Coffee Price per Bag, Capital IQ. Bag = 69kg

Starbucks is expected to increase its demand for coffee, as it continues to expand its operations, mainly in the CAP and EMEA sectors. An increase in the price of the key commodity the company uses would definitely have an impact on its costs and ultimately its revenues.

4.8 Historical Performance

4.8.1 Balance Sheet

Starbucks balance sheet for the period 2012-2016 is presented in the Appendix 1.

Total assets have been roughly the double of total liabilities all throughout the study period. Around 6% of total assets are fixed, with property, plant and equipment constituting the biggest portion. Receivables are detailed net of allowance for doubtful accounts, which are calculated based on historical experience (Starbucks Corporation, 2016). For 2016, accounts receivables were \$768.8 million and the allowance for doubtful accounts was \$9.4 million. This figure represents less than 2% of the total credit the firm has outstanding.

Current liabilities have fluctuated over this five-year period with a strong spike in 2013 due to a litigation resolution. Non-current liabilities increased greatly in the last three years, driven by increases in long-term debt issued by Starbucks. In

2015, the company redeemed \$550 million of Senior Notes with a maturity settled for August 2017. In addition, two new debt issuances were made in the same year. The first consisted of \$500 million of 7-year Senior Notes due 2022 and the second one of \$350 million of 30-year Senior Notes due 2045. Long-term debt stood at \$3.2 billion in 2016. Total equity was \$5890.7 million but remained virtually unchanged from 2015.

4.8.2 Income Statement

Starbucks income statements for the period 2012-2016 are presented in the Appendix 2.

Total revenues have increased consistently at an average of 13% per year all along the study period. For fiscal year 2016, total revenues amounted to \$21 billion.

Cost of sales for 2016 were \$8.5 billion, a 9% increase from fiscal 2015. Gross profit experienced double-digit growth from 2012 to 2016, with its average for the period at 14%. Gross profit over sales also grew during this period, at a percentage point per year, reaching its maximum in 2016, with gross profit being 60% of sales.

The EBIT experienced certain fluctuations along the period, it fell sharply in 2013 due to the unfavorable arbitration with Kraft, which resulted in a litigation charge of \$2784.1 million being paid by Starbucks. This was extraordinary situation that is not consistent with the overall results obtained by Starbucks in the past years. If this litigation charge were not considered in the analysis, EBIT for 2013 would have been \$2.5 billion instead of \$(229) million. Nonetheless, EBIT has grown 16% in 2016, but has shown certain deceleration over the last five-year period.

Net income has increased consistently over the period but not without suffering the impact of Kraft's arbitration, like almost every other item on the income statement. The year 2016 also represented the one with the highest net income, with a result of \$2.8 billion.

Starbucks has shown consistent, double-digit growth over the past five years, despite having unfavorable results in 2013 due to a one-timer, which severely influenced the overall results.

4.8.3 Ratio Analysis

The ratio analysis information is presented in the Appendix 3.

Starbucks gross profit margin increased consistently in the five year period leading to 2016, where it reached 60.07%. Operating profit margin also increased to almost 20% after experiencing a considerable fall in 2013. Based upon these ratios, Starbucks Corporation's financial situation appears to be in good health. The ratios show some sign of deterioration in the years 2008 and 2009 in all categories and the same happened in the year 2013 where the results were even worse. In that year, ROE and ROA were below 1%. Nevertheless, the company was able to recover after these two slowdowns in performance and values for the ratios picked up considerably in the years following these episodes.

Over the past two years results have been on the top end of this ten-year window of analysis. ROE has climbed up to 47.39%, although debt has also increased. The same is the case for the other profitability ratios, which in most cases have improved in the last years.

From a liquidity standpoint, Starbucks showed current ratio values over one for the last seven years (considering a value of one as the threshold for safe current assets to current liabilities ratios).

The debt and equity ratio have remained quite stable over time moving through a 40% to 60% range. In 2013, debt levels rose to a maximum of 61%, this could be attributed to the negative overall performance of the financials caused by the litigation charge of \$2784.1 million dollars Starbucks had to pay Kraft over a legal dispute.

4.9 2016 Performance

Starbucks released its Q2 Financial and Operating results showing signs of improvement in almost all areas of business. The information presented below was extracted from Starbucks Investor Relations' 2017 Financial Release.

Global comparable store sales increased 3%, with an equal increase for the US and a 7% increase in China. Net store openings totaled 427 amounting to a total of 26,161 locations worldwide. Starbucks Reward loyalty program continues to grow. Memberships increased an 11% year-over-year to 13.3 million active members. Earnings per share increased 15% to \$0.45 from March 2016.

Consolidated revenue growth increased 6% and amounted to a record \$5.3 billion. The Americas segment represented the biggest portion of that increase with reported net revenues of \$3.7 billion dollars (8% increase from 2016 results for the same period). China and Asia Pacific segment generated a much smaller revenue of \$768.9 million but this result implied the highest growth of any of the reporting sector, which amounted to 13%. Revenues fell to \$231.7 million for the EMEA segment, mainly due to the absence of revenue related to the sale of the Germany retail operations, as part of the shift to more licensed stores in the region., together with unfavorable currency translation. Channel Development segment was flat at \$461.3 million with respect to 2016, due to an unfavorable revenue deduction adjustment related to past period of \$20.6 million. Without this adjustment, revenue growth would have been approximately 5%. Lastly, All Other Segments revenue fell 14%, to \$111.7 million.

Howard Schultz the CEO and chairman of the company stated, “loyalty, technology and innovation are continuing to fuel our digital flywheel and proper our business forward all around the world” (Starbucks Investor Relations, 2016).

4.10 Qualitative Value Drivers

I have to identify the value drivers for Starbucks in order to estimate its future sales for the next 5 years and determine the company’s fair value.

Sales growth depends mainly on the success of the CAP and EMEA sectors. This is why the economic conditions of the countries that compose these sectors, are of central importance for global revenue growth. Predominantly China, Japan and the UK, which represent the biggest markets and where the most important expansion is expected to take place. At the same time, the main sales income comes from the Americas sector, more specifically from the United States, the biggest market of all. Starbucks strongly relies on the state of USA’s economy to be able to earn the central portion of its total revenues. Therefore, the aggregate GDP for each region was used as one of the factor determining the sales growth for the company. GDP was chosen because of the nature of the industry. Due to the fact that it belongs to the consumer discretionary sector in which goods and services are offered that are not necessities and therefore have a higher correlation with the overall economic activity.

The availability of coffee grains and their price will also be an important factor determining the costs the firm faces, because of its role as one of the main factors of production. The level of production of this resource is of central importance because its availability will ultimately determine its price. Even though Starbucks enters into future and forward contracts to purchase its coffee, a portion of its contracts do not possess a fixed price. On the contrary, everything is fixed, amount of coffee, delivery date and quality of the product, except for the price.

Store growth was also used, in conjunction with GDP growth, as a factor determining the sales growth. Historic growth averages were used to project the increase in stores in each region. A higher amount of stores represent will ultimately determine the amount of revenues Starbucks has.



5. Equity Valuation

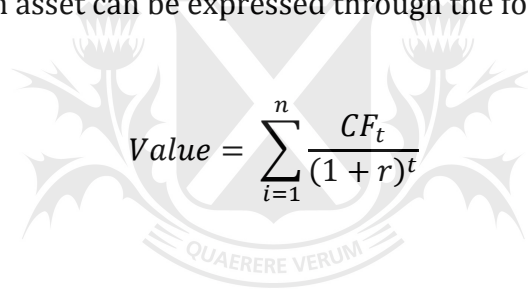
5.1 Methodology

The methods of valuation chosen for this analysis are discounted cash flow (DCF) and relative valuation. I will base the majority of this section upon the theory explained by Aswath Damodaran in “Damodaran On Valuation – Security Analysis for Investment and Corporate Finance”.

5.1.1 Discounted Cash Flow

The DCF valuation method is based upon the present value rule. This rule states, that the value of any asset is the present value of its expected future cash flows.

The value of an asset can be expressed through the following equation:


$$Value = \sum_{t=1}^n \frac{CF_t}{(1+r)^t}$$

Where:

- n = Life of the asset
- CF_t = Cash flow in period t
- r = Discount rate reflecting the riskiness of the estimated cash flow

Since publicly traded firms do not have a finite (at least known) lifespan, the last equation is not completely correct for determining value. Therefore, this same equation can be modified to estimate the value of a firm. The General Version of the Free Cash Flow to the Firm (FCFF) Model includes a calculation of terminal value for a business:

$$Value\ of\ firm = \sum_{t=1}^n \frac{FCFF_t}{(1+WACC)^t} + \frac{\left(\frac{FCFF_{n+1}}{(WACC - g_n)}\right)}{(1+WACC)^n}$$

Where:

- $FCFF_t$ = Expected free cash flow to the firm in period t
- $FCFF_{n+1}$ = Expected free cash flow to the firm in period t + 1
- $WACC$ = Weighted average cost of capital
- $\frac{FCFF \text{ to firm}_{n+1}}{WACC - g_n}$ = Terminal value
- g_n = Perpetual growth rate in FCFF

This is a Two-Stage model, which allows for two different stages of growth. The initial phase is characterized for having a high growth rate and the second phase has a stable growth rate. The first phase lasts n years while the second phase lasts forever. The first term of the equation represents the present value of the cash flows of the firm's estimated high-growth period. The second term represents the terminal value of the firm, which is the expected value to infinity of the future cash flows after the high-growth period is over, which is also expressed in present values.

Thus, the value of the firm can then be written as the sum of the present value of expected FCFF and the terminal value, discounted back at the weighted average cost of capital.

The free cash flow to the firm can be calculated as follows:

$$FCFF = EBIT (1 - \text{tax rate}) + \text{Depreciation} - \text{Capital Expenditure} - \Delta \text{Working Capital}_2$$

Where:

- $EBIT$ = Earnings Before Interest and Tax = Revenues – Operating Expenses
- $\Delta \text{Working Capital} = \Delta \text{Current Assets} - \Delta \text{Current Liabilities}$

The Weighted Average Cost of Capital (WACC) is defined as the weighted average of the costs of the different components of financing used by a firm.

It can be calculated using the following equation:

$$WACC = k_e \left(\frac{E}{(D + E + PS)} \right) + k_d \left(\frac{D}{(D + E + PS)} \right) + k_{ps} \left(\frac{PS}{(D + E + PS)} \right)$$

Where:

- k_e = Cost of equity
- k_d = After-tax cost of debt
- k_{ps} = Cost of preferred stock
- $\left(\frac{E}{(D+E+PS)} \right)$ = Market value of proportion of equity in funding mix
- $\left(\frac{D}{(D+E+PS)} \right)$ = Market value of proportion of debt in funding mix
- $\left(\frac{PS}{(D+E+PS)} \right)$ = Market value of proportion of preferred stock in funding mix

The cost of debt generally depends on three main variables, which are: the current level of interest rates, the default risk of the company and the tax advantage associated with debt. As the level of interest rates increases, the cost of borrowing incurred by the firm will increase. Also, as the company's default risk increases the same will happen. The tax rate will affect the after-tax cost of debt because interests are tax deductible. Due to this relationship, the higher the tax rate the bigger the benefit for the firm.

The cost of preferred stock can be written as:

$$k_{ps} = \frac{\text{Preferred dividend per share}}{\text{Market price per preferred share}}$$

This equation is applicable only if the stock is viewed as perpetual with no special characteristics; at the same time dividends are assumed to be constant in dollar terms. Preferred stock shares some characteristics both with equity and debt. The dividends are specified at the time of issue and are paid before common dividends, like with interest payments on debt. Together with this, the preferred dividend payments are not tax deductible. This type of stocks have a lower risk than common equity but higher than debt. On a pre-tax basis one should expect to see: $k_d < k_{ps} < k_e$.

The Capital Asset Pricing Model (CAPM) is a model used to determine the cost of equity, which is the return that investors require to make an equity investment in a firm. The cost of equity will be calculated as follows:

$$\text{Cost of equity} = k_e = R_f + \beta_e(E(R_m) - R_f)$$

Where:

- R_f = Risk free rate
- $E(R_m)$ = Expected return on the market index
- $(E(R_m) - R_f)$ = Risk Premium
- β_e = Equity beta

The model is based upon a series of assumptions, which are: investors have homogeneous expectations about asset returns and variances, they can borrow and lend at the risk free rate, that all assets are marketable and perfectly divisible, that there are no transaction costs and there are no restrictions on short sales.

The risk free rate is the return an investor can expect to earn in an investment with zero risk. As this type of investment does not actually exist, the proxy variable that is used to determine the risk free rate are government bonds or treasury bills which are considered to have an extremely low risk of default.

The expected return on the market index is usually derived from historical data. The recommendation here is to use the longest period possible to calculate the expected return. At the same time, a geometric average is preferred over an arithmetic average. The reason behind this is that, the geometric average takes into account the compounding of returns over a certain period of time, delivering better predictor over the long term.

The equity beta is the measure of the non-diversifiable risk of the asset. The covariance between the returns on the security and returns on the market portfolio gives us this value of beta. The intuition behind this result is that since investors hold the same diversified portfolio (market portfolio), the risk of an asset is the risk that it adds to this portfolio.

The weights assigned to each one of the components of the WACC should be based upon the market value of debt and equity. This is due to the fact that when these securities are issued, this is done at market value and not book value.

5.1.2 Relative Valuation

Relative valuation consists of deriving the value of an asset from the pricing of comparable assets, standardized using a common variable such as earnings, cash flows, book value, or revenues. The central premise of this method is the assumption that the other firms in the industry are comparable to the firm being valued and that the market, on average, prices these firms correctly.

In this case, I will base my analysis on two multiples, enterprise value to revenues and enterprise value to EBITDA. The EV/EBITDA provides a reference of how overvalued or undervalued a company might be in comparison to its industry peers. This ratio is often a more representative alternative over the market capitalization, because it takes into consideration the debt a company has. On the same note, EV/Revenues works in a very similar way, it provides a quick reference of a company's value in relation to its industry peers. Lower ratios tend to indicate that a company is undervalued, *ceteris paribus*. I will consider both jointly to arrive at a final value. By assigning an equal weighting for both I make sure that the final result is not so dependent on a single multiple and that the value obtained is a more reliable representation of the real value.

First, comparable companies were selected with the criteria explained previously. The EV/EBITDA and EV/Revenues are then calculated for each one of them and a country adjustment is made to avoid any differences in the multiples due to risk factors related to a particular location. The median observation for each multiple was chosen to perform the valuation. Starbucks' 2016 Revenues and EBITDA were multiplied by their corresponding multiple and added together in a 50%-50% weighted average. Finally, to obtain the equity value one must subtract all the financial debt the company has outstanding.

By using multiples, one can find a quick and simple way of obtaining a reference value for a company's equity, which can later be used in comparison with other multiples or with a DCF valuation.

6. Valuing Starbucks

6.1 Assumptions

6.1.1 General Assumptions

Projection Period

The explicit projection period is of five years, from 2017 until 2021. The free cash flows were projected in American dollars in nominal terms.

Terminal Value

As this is an ongoing business with no expected end period for its operations, a terminal value was estimated to calculate its equity value.

Discount Rate

These cash flows were discounted at a nominal rate of 4,76% in dollar terms.

Discount Period

A mid-period discount was used to calculate the present value of the firms operating cash flows given that its revenues do not have a seasonal nature, but on the contrary, occur all along the year.

Regions

Starbucks does not provide specific country financial information. It only presents its financial results in a consolidated manner, as well as by geographic region. Due to this lack of information, the projections were made by region on an aggregate level. Cash flows were discounted with regional WACCs. These discount rates were constructed with weighted averages of country WACCs based on the number of stores in each location.

6.1.2 Macroeconomic Assumptions

The macroeconomic variables used to estimate the firms future cash flows, mainly GDP and inflation, for each operating business segment are shown in the table below:

GDP	Unit	2016	2017	2018	2019	2020	2021
Americas	%	2%	2%	3%	2%	2%	2%
CAP	%	4%	5%	4%	4%	4%	4%
EMEA	%	2%	2%	2%	2%	2%	2%
All Other Segments	%	2%	2%	3%	2%	2%	2%
Channel Development	%	2%	3%	3%	3%	3%	3%
Inflation	Unit	2016	2017	2018	2019	2020	2021
EOP							
Americas	%	1%	3%	2%	2%	2%	2%
CAP	%	3%	3%	3%	4%	4%	4%
EMEA	%	3%	4%	4%	4%	4%	4%
All Other Segments	%	2%	3%	3%	3%	2%	2%
Channel Development	%	3%	3%	3%	3%	3%	3%
Average							
Americas	%	1%	2%	2%	2%	2%	2%
CAP	%	2%	3%	3%	4%	4%	4%
EMEA	%	3%	3%	4%	4%	4%	4%
All Other Segments	%	2%	2%	3%	3%	3%	2%
Channel Development	%	3%	3%	3%	3%	3%	3%

6.1.3 Business Assumptions

Revenues

The company has four operating segments and one non-operating segment. Its four operating segments are composed of Americas, CAP, EMEA and All Other Segments. It's non-operating segment is composed of various businesses but presented as one under Channel Development.

The operating segments generate revenues through three different lines, company-operated stores, licensed stores and foodservice. Licensed stores revenue is in the form of royalties payed by franchisors all around the world. The non-operating segment has two sources of revenue, which are Consumer Packaged Goods and foodservice. The projected revenues for each segment are presented below:

Americas	Unit	2016	2017	2018	2019	2020	2021
Company operated stores	USD'000	13247.4	14048.6	14606.1	15112.0	15543.5	15969.8
Licensed stores	USD'000	1518.5	1652.3	1805.0	1958.3	2119.7	2294.7
Foodservice	USD'000	29.5	29.8	30.2	30.5	30.8	31.1
CAP	Unit	2016	2017	2018	2019	2020	2021
Company operated stores	USD'000	2640.4	3427.3	4369.5	5586.9	7119.2	9100.8
Licensed stores	USD'000	292.3	349.4	417.1	496.9	590.4	702.1
Foodservice	USD'000	6.1	6.2	6.3	6.4	6.5	6.6
EMEA	Unit	2016	2017	2018	2019	2020	2021
Company operated stores	USD'000	732.0	736.5	731.4	729.3	726.4	725.1
Licensed stores	USD'000	339.5	388.7	446.5	512.6	588.2	674.8
Foodservice	USD'000	53.4	54.3	55.5	56.7	57.8	58.8
All Other Segments	Unit	2016	2017	2018	2019	2020	2021
Company operated stores	USD'000	224.3	229.2	235.3	240.1	244.4	248.9
Licensed stores	USD'000	3.9	4.0	8.0	15.9	31.9	63.7
Foodservice	USD'000	296.1	299.3	303.3	306.4	309.2	312.0
Channel Development	Unit	2016	2017	2018	2019	2020	2021
CPG	USD'000	1488.2	1528.7	1574.5	1618.6	1661.7	1706.5
Foodservice	USD'000	444.3	456.4	470.1	483.2	496.1	509.5

Revenues were estimated taking into consideration the GDP growth for each region together with the expected new store openings.

Costs

Costs are divided into four categories. Cost of sales and occupancy costs, which are comprised mainly of commodity prices and rent or leases on the properties used by the company. Store operating expenses are mainly related to investment in digital platforms and in store partners. The firm only incurs store-operating expenses with its company-operated stores, given that it does not operate its licensed stores and thus does not incur in any costs. Other operating expenses represent a smaller portion of total costs and are generally related to marketing expenses. Lastly, general and administrative expenses are composed primarily of salaries and employee compensations.

These costs were projected based on historical averages together with inflation and store growth projections for the explicit projection period. Individual items such as salaries, marketing expenses, rent or commodity prices were not estimated individually given that the firm does not provide this information on its annual reports. Therefore, I assumed that the inflation levels, the amount of new stores and the price of coffee would determine these variables.

Americas	Unit	2016	2017	2018	2019	2020	2021
Cost of sales	USD'000	5271.9	5532.4	5614.9	5697.7	5748.0	5807.9
Store operating expenses	USD'000	4909.3	5130.9	5384.2	5635.9	5894.4	6165.4
Other operating expenses	USD'000	96	138.5	147.9	156.9	168.6	180.6
General and administrative expenses	USD'000	776.09	826.8	884.3	943.5	1005.8	1072.3
CAP	Unit	2016	2017	2018	2019	2020	2021
Cost of sales	USD'000	1296.7	1647.5	2026.9	2512.7	3103.9	3856.1
Store operating expenses	USD'000	779.4	965.3	1200.6	1500.0	1877.7	2351.4
Other operating expenses	USD'000	70.3	74.8	80.7	87.5	95.1	104.4
General and administrative expenses	USD'000	374.1	447.5	537.7	649.0	784.7	949.3
EMEA	Unit	2016	2017	2018	2019	2020	2021
Cost of sales	USD'000	565.0	584.8	593.8	609.9	628.4	652.7
Store operating expenses	USD'000	260.6	269.3	280.9	292.7	303.9	314.8
Other operating expenses	USD'000	57.0	62.3	67.3	72.9	79.3	87.0
General and administrative expenses	USD'000	151.3	169.2	191.0	215.3	241.8	271.1
All Other Segments	Unit	2016	2017	2018	2019	2020	2021
Cost of sales	USD'000	316.5	321.4	329.9	339.5	353.4	377.1
Store operating expenses	USD'000	115	117.8	121.4	124.7	127.8	131.0
Other operating expenses	USD'000	91.4	107.9	116.5	126.2	137.2	150.6
General and administrative expenses	USD'000	41.2	42.9	45.3	47.9	51.1	55.9
Channel Development	Unit	2016	2017	2018	2019	2020	2021
Cost of sales	USD'000	1042.6	1071.0	1103.1	1133.9	1164.1	1195.5
Other operating expenses	USD'000	228.5	276.4	298.4	323.3	351.6	385.8
General and administrative expenses	USD'000	17.9	18.4	19.0	19.5	20.1	20.7

Depreciation & Amortization

Depreciations and amortizations were estimated based on its historic ratio average with respects to PP&E and Intangible Assets.

Depreciation & Amortization	Unit	2012	2013	2014	2015	2016
PP&E	USD'000	2658.9	3200.5	3519	4088.3	4533.8
Other Intangible Assets	USD'000	-	274.80	273.50	520.40	516.30
D&A	USD'000	550.3	621.4	709.6	893.9	980.8
D&A/PP&E + Other Intangible Assets	%	21%	18%	19%	19%	19%
Historic Average	%	19%				

Depreciation & Amortization	Unit	2017	2018	2019	2020	2021
PP&E	USD'000	5184.4	5928.3	6778.9	7751.6	8863.9
Other Intangible Assets	USD'000	516.3	516.3	516.3	516.3	516.3
D&A	USD'000	1107.1	1251.6	1416.8	1605.7	1821.8

Income Tax

The company expects an effective tax rate of 34% for fiscal 2017. This rate was projected flat for the explicit projection period.

Working Capital

Working capital days were estimated based upon historic figures of the company for each region. The table below shows days of accounts payable and receivable for Starbucks:

Working Capital	Unit	2016
Americas		
Days of accounts payable	days	31
Days of account receivable	days	12
CAP		
Days of accounts payable	days	53
Days of account receivable	days	25
EMEA		
Days of accounts payable	days	50
Days of account receivable	days	26
All Other Segments		
Days of accounts payable	days	13
Days of account receivable	days	8

Capital Expenditure

Capital expenditures were calculated as a fixed percentage over gross sales, based on the historic average of capital expenditure over total revenues ratio.

Net debt was determined as the difference between non-operating assets and non-operating liabilities as seen on the table below:

Net Debt	Unit	2016
Non Operating Assets		
Cash and Cash Equivalents	USD'000	2128.8
Investments	USD'000	134.4
Non Operating Liabilities		
Accrued Liabilities	USD'000	1999.1
Other Liabilities	USD'000	3891.9
Net Debt		-3627.8

6.2 Equity Value

Based on the information detailed above about the projections made for Starbucks key business variables, the equity value of the firm is presented below:

Enterprise Value (02/10/16)	USD'000	97,105.18
Non Operating Assets	USD'000	2,263.2
Non Operating Liabilities	USD'000	-5,891.0
Equity Value (02/10/16)	USD'000	93,477.38
Shares Outstanding		1,500
Price per Share		62.32

Starbucks equity value is estimated at \$93,477,380,000 once net financial debt is subtracted from the enterprise value. This equity value divided by the 1.5 billion shares outstanding gives a price per share of \$62.32.

6.3 Sensitivity Analysis

A sensitivity analysis was performed on various business variables to further assess its impact on the business results.

Macroeconomic & Financial Variables

A sensitivity analysis was performed on the following variables:

- Risk Free Rate: the base scenario used a US Treasury bond with a maturity of 30 years, alternative values for maturities of 20 and 10 years were tested.

Macroeconomic & Financial Variables		
Risk Free Rate		Equity Value (USD MM)
30Y	2.34%	93,477.38
20Y	2.01%	100,436.03
10Y	1.63%	109,793.04

Equity value is very sensitive to changes in the risk free rate. By changing the selected maturity from 30 years to 20 years, which implies a change of -0.33% on the interest rate, the equity value increases over almost 7.5%. The same happens when the selected maturity is of 10 years. The rate falls by -0.71% respectively, equity value increases by 17.45%.

- Perpetuity growth: The 2018-2050 world GDP growth average was selected, different scenarios were analyzed with higher and lower growth rates.

Perpetuity Growth		Equity Value (USD MM)
+1%	3.29%	145,886.67
+0.5%	2.79%	113,716.51
World GDP Average 2021-2050	2.29%	93,477.38
-0.5%	1.79%	79,570.21
-1%	1.29%	69,425.45

The equity value varies considerably due to small changes in the perpetuity growth rate. This happens because the proportion of terminal value over total enterprise value is of 87% and thus has a considerable impact on value.

- Discount period: A mid-period discount was used. An alternative scenario was tested with an end of period discount, although this kind of discount applies for seasonal businesses.

Discount Period	Equity Value (USD MM)
Mid-period	93,477.38
End of Period	91,143.35

If an end of period discount is considered, equity value falls 2.56%. In this particular case, as the discount period has a direct impact on the operating cash flows of the explicit projection period, the value is not considerably affected.

- Americas GDP & Inflation: Taking into consideration the Americas segment generates the biggest portion of revenue for the company, a sensitivity analysis was performed over the GDP and inflation projections.

United States Macroeconomic Projections		Equity Value (USD MM)
GDP		
+1%		99,067.95
+0.5%		95,078.00
Actual GDP Forecast		93,477.38
-0.5%		87,263.41
-1%		83,437.60
Inflation		
+1%		83,753.25
+0.5%		87,482.56
Actual Inflation Forecast		93,477.38
-0.5%		94,736.57
-1%		98,263.18

Analyzed independently, the GDP has a positive correlation with equity value, while inflation has a negative correlation. GDP growth affects revenues directly while costs are influenced by store growth and inflation.

6.4 Relative Valuation

For the multiple valuation, the following group of comparable companies was selected in order to obtain the EV/Revenues and EV/EBITDA ratios for the analysis. The companies, together with their selected financial information and ratios are shown below:

Guideline Company	Location	Revenue MM USD	Total Market Cap. MM USD	Enterprise Value	EV/Revenues	EV/EBITDA	EBITDA MM USD	Country adjustment	EV/Revenues	EV/EBITDA
Mc Donald's Corporation	United States	24621.90	105,519	129,746	5.29x	13.53x	9,336.70	0.00%	5.29x	13.53x
Yum! Brands, Inc.	United States	6366.00	22,664	31,536	4.88x	9.94x	1,964.00	0.00%	4.88x	9.94x
Whitbread PLC	United Kingdom	4038.71	7,101	9,911	2.67x	10.04x	1,038.29	23.68%	3.30x	12.42x
Cracker Barrel Old Country Store, Inc.	United States	2919.69	3,873	4,091	1.40x	11.60x	385.35	0.00%	1.40x	11.60x
Dunkin' Brands Group, Inc.	United States	828.89	5,055	7,131	8.60x	15.99x	433.48	0.00%	8.60x	15.99x
Panera Bread Company	United States	2795.37	5,860	5,625	2.21x	13.23x	405.30	0.00%	2.21x	13.23x
Chipotle Mexican Grill, Inc.	United States	3904.38	14,840	12,838	3.69x	38.06x	204.81	0.00%	3.69x	38.06x
Darden Restaurants, Inc.	United States	6994.60	10,980	9,596	1.57x	9.97x	940.80	0.00%	1.57x	9.97x
Wendy's Company	United States	1589.88	3,888	5,645	4.35x	13.54x	380.24	0.00%	4.35x	13.54x
Domino's Pizza, Inc.	United States	2394.38	10,008	11,266	4.74x	21.07x	481.38	0.00%	4.74x	21.07x

To perform the analysis the median of both the EV/Revenues and EV/EBITDA were selected. The results are shown below:

Ratio	Adjusted Multiple	Weighting	Weighted Enterprise Value (EV)
LTM EV/Revenues	Median 4.02x	50%	42,877.95
LTM EV/EBITDA	Median 13.38x	50%	33,525.74
Enterprise value (minority)	USD		76,403.69
Control Premium	%	31%	24,054.43
Enterprise value (control)			100,458.11
Less: Financial Debt	USD		-3,627.80
Equity value	USD		96,830.31

The enterprise value was of \$76 billion, after adding a control premium of \$24 billion and subtracting \$3.6 billion in financial debt, I obtained an equity value of \$96.8 billion.

7. Conclusion

Based upon the valuation methodology detailed previously and the projection assumptions for the explicit forecast period, the estimated equity value for Starbucks Corporation is detailed in the chart below:

Enterprise Value (02/10/16)	USD'000	97,105.18
Non Operating Assets	USD'000	2,263.2
Non Operating Liabilities	USD'000	-5,891.0
Equity Value (02/10/16)	USD'000	93,477.38
Shares Outstanding		1,500
Price per Share		62.32

The equity value obtained through the discounted cash flow valuation method is in line with the result obtained by using multiples to determine Starbucks value. Although slightly higher, the multiple valuation validates the results obtained in the analysis.

8. Appendix

Appendix 1: Balance Sheet

Balance Sheet - Numbers In MM		Unit	2012 [r]	2013 [r]	2014 [r]	2015 [r]	2016 [r]
Assets							
Current Assets							
Cash And Cash Equivalents	USD	1188.6	2575.7	1708.4	1530.1	2128.8	
Short Term Investments	USD	848.4	658.1	135.4	81.3	134.4	
Net Account Receivables	USD	485.9	561.4	631.0	719.0	768.8	
Inventories	USD	1241.5	1111.2	1090.9	1306.4	1378.5	
Prepaid expenses and other current assets	USD	196.5	287.7	285.6	334.2	350.0	
Net Deferred Income Taxes	USD	238.7	277.3	317.4	381.7	-	
Total Current Assets	USD	4199.6	5471.4	4168.7	4352.7	4760.5	
Fixed Assets							
Long Term Investments	USD	116.0	58.3	318.4	312.5	1141.7	
Equity and cost investments	USD	459.9	496.5	514.9	352.0	354.5	
Property, plant and equipment	USD	2658.9	3200.5	3519.0	4088.3	4533.8	
Deferred Income Taxes	USD	-	967.0	903.3	828.9	885.4	
Other Long-Term Assets	USD	385.7	185.3	198.9	415.9	417.7	
Other Intangible Assets	USD	-	274.8	273.5	520.4	516.3	
Goodwill	USD	399.1	862.9	856.2	1575.4	1719.6	
Total Fixed Assets	USD	4019.6	6045.3	6584.2	8093.4	9569.0	
Total Assets	USD	8219.2	11516.7	10752.9	12446.1	14329.5	
Change	%	-	40%	-7%	16%	15%	
Liabilities and Equity							
Current Liabilities							
Accounts Payable	USD	398.1	491.7	533.7	684.2	730.6	
Accrued litigation charge	USD	-	2784.1	-	-	-	
Accrued Liabilities	USD	1133.8	1269.3	1514.4	1760.7	1999.1	
Insurance Reserves	USD	167.7	178.5	196.1	224.8	246.0	
Stored Value Card Liability	USD	-	-	794.5	983.8	1171.2	
Current portion of long-term debt	USD	-	-	-	-	400.0	
Deferred revenue	USD	510.2	653.7	-	-	-	
Total Current Liabilities	USD	2209.8	5377.3	3038.7	3653.5	4546.9	
Non current Liabilities							
Long Term Debt	USD	549.6	1299.4	2048.3	2347.5	3202.2	
Other Long-Term Liabilities	USD	345.3	357.7	392.2	625.3	689.7	
Deferred Long Term Liability Charges	USD	-	-	-	-	-	
Total Non Current Liabilities	USD	894.9	1657.1	2440.5	2972.8	3891.9	
Total Liabilities	USD	3104.7	7034.4	5479.2	6626.3	8438.8	
Change	%	-	127%	-22%	21%	27%	
D/A	%	38%	61%	51%	53%	59%	
Stockholders' Equity							
Common Stock	USD	0.7	0.8	0.7	1.5	1.5	
Additional Paid-in Capital	USD	39.4	282.1	39.4	41.1	41.1	
Retained Earnings	USD	5046.2	4130.3	5206.6	5974.8	5949.8	
Accumulated other comprehensive income/(loss)	USD	22.7	67.0	25.3	-199.4	-108.4	
Total Stockholder Equity	USD	5109.0	4480.2	5272.0	5818.0	5884.0	
Noncontrolling Interest	USD	5.5	2.1	1.7	1.8	6.7	
Total Equity	USD	5114.5	4482.3	5273.7	5819.8	5890.7	
Change	%	-	-12%	18%	10%	1%	
E/A	%	62%	39%	49%	47%	41%	
Total Liabilities and Equity	USD	8219.2	11516.7	10752.9	12446.1	14329.5	
Change	%	-	40%	-7%	16%	15%	
D/E	%	61%	157%	104%	114%	143%	
Retained Earnings / Net Income		27%	0%	40%	46%	47%	

Appendix 2: Income Statement

Income Statement - Numbers in MM	Unit	2012 [r]	2013 [r]	2014 [r]	2015 [r]	2016 [r]
Company-operated Stores	USD	10,534.5	11,793.2	12,977.9	15,197.3	16,844.1
Change	%	-	12%	10%	17%	11%
Licensed Stores	USD	1,210.3	1,360.5	1,588.6	1,861.9	2,154.2
Change	%	-	12%	17%	17%	16%
CPG, Foodservice and Other	USD	1,532.0	1,713.1	1,881.3	2,103.5	2,317.6
Change	%	-	12%	10%	12%	10%
Total Revenue	USD	13,276.8	14,866.8	16,447.8	19,162.7	21,315.9
Change	%	-	12%	11%	17%	11%
			2%	3%	3%	2%
Cost of Sales including occupancy costs	USD	5,813.3	6,382.3	6,858.8	7,787.5	8,511.1
Change	%	-	10%	7%	14%	9%
Cost of Sales / Total Rev		44%	43%	42%	41%	40%
Gross Profit	USD	7,463.5	8,484.5	9,589.0	11,375.2	12,804.8
Change	%	-	14%	13%	19%	13%
% over Sales	%	56%	57%	58%	59%	60%
Store Operating Expenses	USD	3,918.1	4,286.1	4,638.2	5,411.1	6,064.3
Other Operating expenses	USD	429.9	431.8	457.3	522.4	545.4
Depreciation and amortization expenses	USD	550.3	621.4	709.6	893.9	980.8
General and administrative expenses	USD	801.2	937.9	991.3	1,196.7	1,360.6
Litigation charge/(credit)	USD	-	2,784.1	-20.2	-	-
Restructuring charges	USD	-	-	-	-	-
Total Operating Expenses	USD	11,512.8	15,443.6	13,635.0	15,811.6	17,462.2
Change	%	-	34%	-12%	16%	10%
% over Sales	%	87%	104%	83%	83%	82%
Income from equity investees	USD	210.7	251.4	268.3	249.9	318.2
Gain on sale of properties	USD	0.0	-	-	-	-
Operating Income/(Loss)	USD	1,974.7	-325.4	3,081.1	3,601.0	4,171.9
Change	%	-	-116%	-1047%	17%	16%
% over Sales	%	15%	-2%	19%	19%	20%
Gain resulting from acquisition of joint venture	USD	-	-	-	390.6	-
Loss on extinguishment of debt	USD	-	-	-	-61.1	-
Interest income and other, net	USD	94.4	123.6	142.7	43.0	108.0
Interest expense	USD	-32.7	-28.1	-64.1	-70.5	-81.3
Earnings/(loss) before income taxes	USD	2,036.4	-229.9	3,159.7	3,903.0	4,198.6
Change	%	-	-111%	1474%	24%	8%
% over Sales	%	15%	-2%	19%	20%	20%
Income tax expense/(benefit)	USD	674.4	-238.7	1,092.0	1,143.7	1,379.7
Net earnings including non controlling interests	USD	1,362.0	8.8	2,067.7	2,759.3	2,818.9
Change	%	-	-99%	23397%	33%	2%
% over Sales	%	10%	0%	13%	14%	13%
Net earnings/(loss) attributable to non controlling interests	USD	0.9	0.5	-0.4	1.9	1.2
Net earnings attributable to Starbucks	USD	1,361.1	8.3	2,068.1	2,757.4	2,817.7
Change	%	-	-99%	24817%	33%	2%
% over Sales	%	10%	0%	13%	14%	13%

Appendix 3: Financial Ratios

Ratio Analysis					
Profitability	2012	2013	2014	2015	2016
Gross Profit Margin	56.21%	57.07%	58.30%	59.36%	60.07%
Operating Profit Margin	14.87%	-2.19%	18.73%	18.79%	19.57%
Net Profit Margin	10.25%	0.06%	12.57%	14.39%	13.22%
Total Asset Turnover	1.62	1.51	1.48	1.65	1.59
Return on Equity (ROE)	26.61%	0.19%	39.22%	47.38%	47.83%
Return on Assets (ROA)	16.96%	0.37%	19.15%	24.38%	21.65%
Cost of Sales	43.79%	42.93%	41.70%	40.64%	39.93%
Liquidity					
Current Ratio	1.90	1.02	1.37	1.19	1.05
Acid Test Ratio (Quick)	0.76	0.58	0.77	0.62	0.64
Cash Ratio	0.54	0.48	0.56	0.42	0.47
Leverage					
Debt-Asset Ratio	0.38	0.61	0.51	0.53	0.59
Debt-Equity Ratio	0.61	1.57	1.04	1.14	1.43

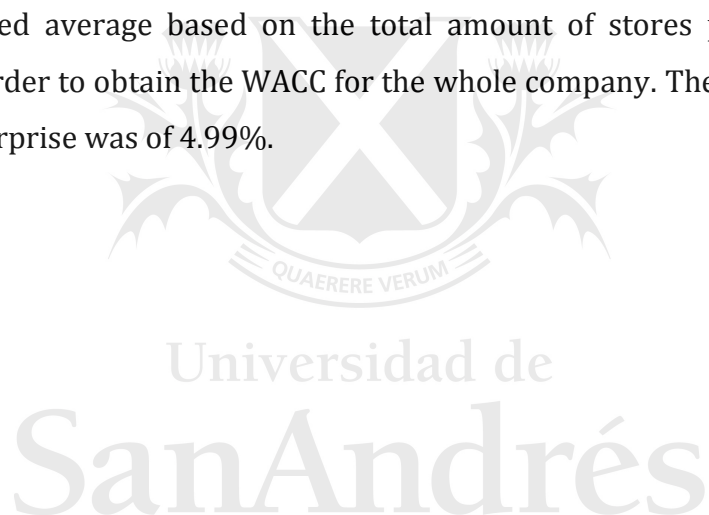


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Appendix 4: WACC

Region	Region WACC	Number of Stores	Store Weight	Adjusted Region WACC
Americas	4.39%	15,584	62.21%	2.73%
CAP	5.84%	6,439	25.70%	1.50%
EMEA	6.52%	2,640	10.54%	0.69%
All Other Segments	4.38%	388	1.55%	0.07%
Total Stores		25,051	WACC	4.99%

Discount rates for each region and for Starbucks Corporation as a whole were calculated in the same manner. First, the WACC for each country was calculated separately. The WACCs for each country were grouped into the corresponding regions and a weighted WACC for each region, based on the total amount of stores in each country, was calculated. Once the region discount rates were established, a second weighted average based on the total amount of stores per region was calculated in order to obtain the WACC for the whole company. The final WACC for the whole enterprise was of 4.99%.



Appendix 5: Projected Income Statement

Income Statement							
Revenue - Company-operated Stores	USD'000	16,844.1	18,441.6	19,942.2	21,668.3	23,633.5	26,044.5
Revenue - Licensed Stores	USD'000	2,154.2	2,394.5	2,676.6	2,983.8	3,330.1	3,735.4
Revenue - Foodservice & Other	USD'000	2,317.6	2,374.7	2,439.8	2,501.7	2,562.0	2,624.6
Total Gross Revenues	USD'000	21,315.9	23,210.7	25,058.6	27,153.8	29,525.7	32,404.4
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Cost of Sales	USD'000	8,511.1	9,157.0	9,668.5	10,293.7	10,997.9	11,889.4
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Gross Margin	USD'000	12,805	14,054	15,390	16,860	18,528	20,515
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<i>Gross Margin/Total Gross Revenues</i>	%	60%	61%	61%	62%	63%	63%
<hr/>							
Store Operating Expenses	USD'000	6,064.3	6,483.4	6,987.1	7,553.2	8,203.8	8,962.5
Other Operating Expenses	USD'000	545.4	659.9	710.7	766.8	831.8	908.4
Operating Costs	USD'000	6,609.7	7,143.3	7,697.8	8,320.0	9,035.6	9,871.0
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Non-operating Costs							
General & Administrative Expenses	USD'000	1,360.6	1,504.8	1,677.3	1,875.1	2,103.6	2,369.2
Total Non-Operating Costs	USD'000	1,360.6	1,504.8	1,677.3	1,875.1	2,103.6	2,369.2
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EBITDA	USD'000	4,835	5,406	6,015	6,665	7,389	8,275
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<i>EBITDA/Total Gross Income</i>	%	23%	23%	24%	25%	25%	26%
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Depreciation & Amortizations	USD'000	980.8	1,107.1	1,251.6	1,416.8	1,605.7	1,821.8
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EBIT	USD'000	3,854	4,298	4,763	5,248	5,783	6,453
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Financial Results	USD'000	343.7	-	-	-	-	-
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EBT	USD'000	4,197	4,298	4,763	5,248	5,783	6,453
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Income Tax	USD'000	1,379.70	2,214.3	2,470.7	2,747.8	3,058.1	3,432.9
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Net Income	USD'000	2,817.70	2,084.13	2,292.78	2,500.32	2,724.82	3,020.28

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