STARBUCKS

FRAMEWORK Investing

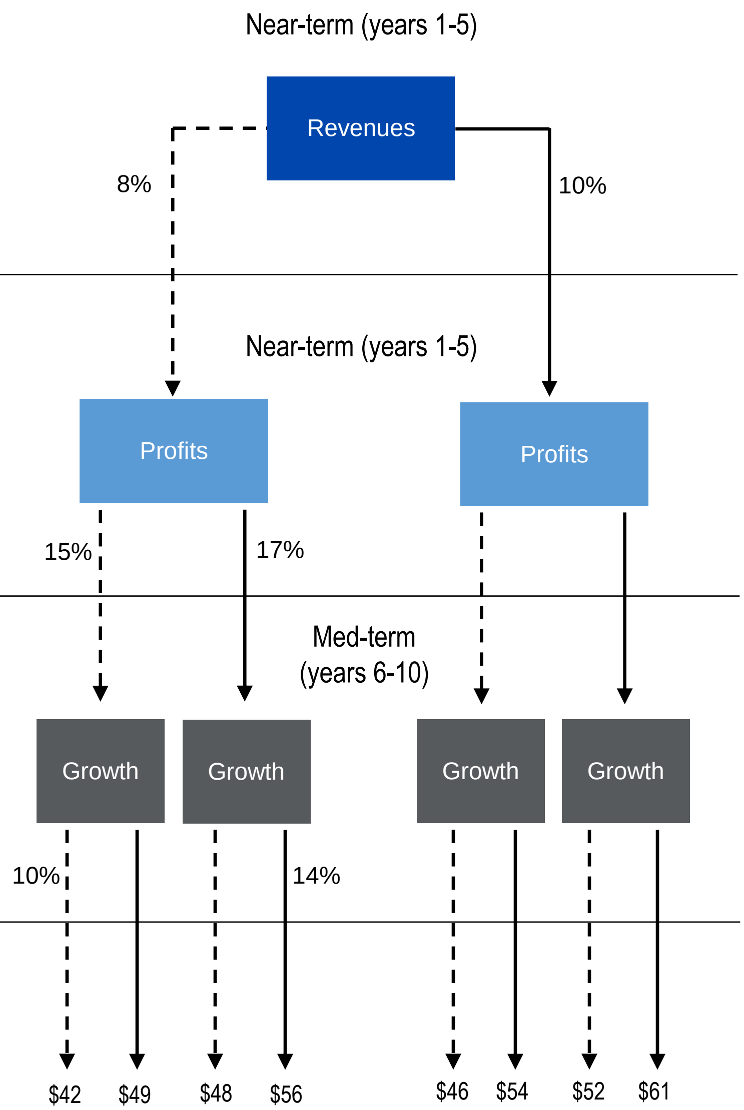
Valuation Waterfall

Revenue Growth
Starbucks main source of revenue is the maturing Americas (~70%) business; China/APAC (~15%) is quickly growing, and “Channel Development” (K-Cups, canned coffee) (~10%) is important as well. Recent sudden slowdown in same store sales (SSS), as the company shifts its growth strategy to opening new stores; new stores cannibalize SSS. The company has guided for a high single digit revenue growth during the full-year 2018.

Profitability
We have seen notable jump in profits (measured on an OCP basis) from 2013 onwards. Profit averaged 9% during the 5-year period from 2008-2012 and now is in the 15% range. Big story is increasing operating leverage, likely to be related to Teavana acquisition (’13) and profits from brand extensions such as K-Cup. Our worst-case average profitability represents historical high. Best-case assumes continued profitability improvement.

Medium-Term Cash Flow Growth
SBUX spends around 35% of its profits on investments, of which roughly $400mm / year is stock-based executive comp. Starbucks will be acquiring remaining 50% share of East China JV next year for $1.3 billion – largest acquisition to date, representing roughly a third of its 2017 profit. Our best-case medium-term growth assumptions relate to build-out of China locations and continued maturation of US business.

Fair Value Range
Our fair value range extends from $42 to $61/ share and six out of eight of the values lie between $46 and $56 per share. The average of all our FV scenarios is $51 per share, 15% lower than the present price. Best-best-best valuation driver scenario only a smidge higher than present market price. While not yet overvalued, the firm is pushing the envelope of it. Starbuck lattes aren’t the only thing about the co. that’s expensive, in our opinion.



13 December 2017

Methodology

Framework Investing analyses focus on three main valuation drivers: revenue growth, profitability, and medium-term cash flow growth. We estimate a best- and worst-case scenario for each of these drivers resulting in a total of $2^3 = 8$ fair value scenarios based on discounted cash flow methodology. Profitability is measured by Owners’ Cash Profit (OCP) margin and our measure of free cash flow is termed Free Cash Flow to Owners (FCFO). We use a discount rate of 10% for large capitalization stocks. A wide spread of lowest and highest fair values indicates a firm whose value is uncertain. Risk depends on the stock price’s relationship to the valuation range. Best-case scenarios are represented with a solid line; worst-case scenarios, with a dotted one.