



# Starbucks Corporation (SBUX)

Updated May 11<sup>th</sup>, 2018 by Aristofanis Papadatos

## Key Metrics

<b>Current Price:</b> \$58	<b>5 Year CAGR Estimate:</b> 15.9%	<b>Quality Percentile:</b> N/A
<b>Fair Value Price:</b> \$64	<b>5 Year Growth Estimate:</b> 12.0 %	<b>Momentum Percentile:</b> N/A
<b>% Fair Value:</b> 91%	<b>5 Year Valuation Multiple Estimate:</b> 1.8%	<b>Total Return Percentile:</b> N/A
<b>Dividend Yield:</b> 2.1%	<b>5 Year Price Target</b> \$112	<b>Valuation Percentile:</b> N/A

## Overview & Current Events

Starbucks is a global coffee retailer, with more than 28,000 stores in 76 countries. Since its IPO in 1992, it has rewarded its shareholders with an approximate 200-fold increase. It has grown its annual revenues by at least \$1 B for eight consecutive years while it has grown its EPS more than 5-fold over this period, from \$0.40 in 2009 to \$2.06 last year.

Nevertheless, the stock has dramatically underperformed the market during the last two years, as it has gained only 6% whereas S&P has rallied 33%. The main concern is the recent deceleration of the company, as its same-store sales growth has slowed to 2%. The domestic segment has markedly slowed, thus causing concerns that it is approaching its saturation point. The other reason behind the underperformance is the change of the CEO last year. Howard Schultz was exceptional and led the company through its exceptional growth. Therefore, as the quality of the management is a critical factor in long-term success, particularly given the breathless expansion rate of the company, the market is justified to view the change of the CEO as a risk factor. The stock plunged 10% on the announcement of this change.

Nevertheless, Starbucks still has exciting growth prospects. The coffee leader currently operates in 76 countries and has ample room to expand further. In addition, it has tremendous potential in China, which will have a middle class of more than 600 M people by 2022 and will eventually become a larger market than the U.S. In fact, Starbucks opens a new store in China every 15 hours and expects to maintain this rate for years.

The company can also grow in many other dimensions, apart from coffee. It expects its Teavana business to reach \$3 B annual sales in the next five years while it also expects to double the size of its food business by 2021. Moreover, in the latest conference call, management repeatedly emphasized a focus on increasing the afternoon traffic in its stores.

Finally, Nestle recently acquired the right to market the coffee products of Starbucks outside its shops for \$7.2 B. Starbucks will use the proceeds to accelerate its share repurchases.

## Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
<b>EPS</b>	\$0.36	\$0.40	\$0.64	\$0.76	\$0.90	\$1.13	\$1.36	\$1.58	\$1.91	\$2.06	<b>\$2.50</b>	<b>\$4.40</b>
<b>DPS</b>	---	---	\$0.12	\$0.26	\$0.34	\$0.42	\$0.52	\$0.64	\$0.80	\$1.00	<b>\$1.20</b>	<b>\$2.20</b>

Thanks to the recent tax reform and the performance of Starbucks in the first half of its fiscal year, the analysts and its management expect its EPS to climb to \$2.50 this year. Moreover, thanks to the above mentioned growth prospects of the company, its management has repeatedly confirmed that it has long-term goals of 3%-5% annual sales growth and 12% adjusted EPS growth. Therefore, it is reasonable to expect 12% EPS growth in the upcoming years, from \$2.50 this year to \$4.40 in 2023.

## Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
<b>Avg. P/E</b>	26.4	16.0	18.7	22.8	27.5	26.5	27.9	30.2	30.4	27.7	<b>23.2</b>	<b>25.4</b>
<b>Avg. Yld.</b>	---	---	1.0%	1.5%	1.4%	1.4%	1.4%	1.3%	1.4%	1.8%	<b>2.1%</b>	<b>2.0%</b>

Thanks to its exceptional performance, Starbucks has always enjoyed a premium valuation. As a result, its 10-year average P/E ratio is 25.4 whereas the stock is now trading at a slightly lower P/E of 23.2. As it is reasonable to expect the

stock to revert to its average valuation level in five years, the stock is likely to enjoy a 1.8% annualized gain thanks to the expansion of its P/E ratio over this time frame.

Due to the premium valuation that Starbucks always enjoys, many investors hesitate to buy it and instead wait for a lower entry point. However, investors should realize that it is a shame to miss the long-term rally of the stock for a slightly lower entry point. The choice of the entry point is much more critical in slow-growth stocks that are unlikely to grow EPS significantly. That's not the case at Starbucks.

### Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
<b>GP/A</b>	101%	97.7%	98.5%	92.2%	90.8%	73.7%	89.2%	91.6%	89.5%	92.9%	<b>90.0%</b>	<b>90.0%</b>
<b>Debt/A</b>	56.1%	45.2%	42.3%	40.4%	37.8%	61.1%	51.0%	53.1%	58.8%	62.0%	<b>73.1%</b>	<b>70.0%</b>
<b>Int. Cov.</b>	11.6	258.2	44.9	61.1	51.9	303.9	149.8	144.5	141.3	143.5	<b>116.2</b>	<b>130.0</b>
<b>Payout</b>	0%	0%	18.8%	34.2%	37.8%	37.2%	38.2%	40.5%	41.9%	48.5%	<b>48.0%</b>	<b>50.0%</b>
<b>Std. Dev.</b>	42.4%	43.2%	22.1%	21.6%	28.3%	13.4%	14.9%	16.4%	14.5%	14.6%	<b>15.0%</b>	<b>17.0%</b>

Starbucks has a strong brand image and is trying to further strengthen it via the opening of state-of-the-art reserve stores. It opened its first store in Seattle this year and plans to open up to 1000 reserve stores worldwide. Moreover, while the company is affected by recessions, its results are fairly resilient during such periods. In the Great Recession, its EPS fell 18% from 2007 to 2008 but rebounded strongly thereafter. To be sure, its EPS in 2010 were 45% higher than its pre-crisis EPS. On the other hand, in the event of a recession, Starbucks will incur a steep contraction of its P/E ratio. Therefore, its shareholders should be prepared for significant short-term downside in such an event.

### Final Thoughts & Recommendation

Starbucks has traded within a markedly narrow range, between \$52 and \$65, for almost three years. Whenever such a pattern has been observed in the past, the stock has enjoyed a strong rally afterwards. This is likely to prove the case once again thanks to the growth prospects of the company. The stock can offer a 15.9% average annual return over the next five years thanks to 12.0% EPS growth, its 2.1% dividend and a 1.8% annualized expansion of its P/E ratio.

### Total Return Breakdown by Year

