



Starbucks Corporation (SBUX)

Updated July 27th, 2018 by Ben Reynolds

Key Metrics

Current Price: \$51	5 Year CAGR Estimate: 15.4%	Volatility Percentile: 13.8%
Fair Value Price: \$53	5 Year Growth Estimate: 12.0 %	Momentum Percentile: 16.4%
% Fair Value: 97%	5 Year Valuation Multiple Estimate: 0.6%	Valuation Percentile: 63.4%
Dividend Yield: 2.8%	5 Year Price Target \$94	Total Return Percentile: 92.0%

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 return. It has grown its annual revenues by at least \$1 billion 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 over the last year; the S&P 500 is up 15% while Starbucks is down 11%. The main concern is the recent growth deceleration, as its same-store sales growth has slowed to 1% in its most recent quarter. The domestic segment has been especially impacted. The other reason behind the underperformance is the change of the CEO last year. Howard Schultz led the company through its exceptional growth. Starbucks reported same store sales growth of 1% in its most recent quarter (released 7/26/18). Sales growth was driven by an increase in ticket price; the number of transactions declined slightly across all reported segments. Revenue grew 11% and adjusted earnings-per-share gained 13% versus the same quarter a year ago. The company grew its store count by 1.8% versus the 2nd quarter of 2018. The bulk of Starbucks's growth is coming from store expansion and not increasing comparable store sales. Starbucks also reduced its guidance for fiscal 2018 to \$2.41. We previously expected earnings-per-share of \$2.50 on the year for Starbucks. We have updated our 2018 earnings estimate accordingly.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	\$0.36	\$0.40	\$0.64	\$0.76	\$0.90	\$1.13	\$1.36	\$1.58	\$1.91	\$2.06	\$2.41	\$4.25
DPS	----	----	\$0.12	\$0.26	\$0.34	\$0.42	\$0.52	\$0.64	\$0.80	\$1.00	\$1.44	\$2.20

Starbucks growth is slowly decelerating off high numbers, but the company still has above-average growth prospects ahead. Starbucks is still growing its store count in the US, but will grow its number of stores in the US at a slower clip over the next several years. Starbucks is under-leveraged, and will take on more debt over the next several years to both fund more store openings in China and other international markets, and to repurchase shares.

The company can also grow in many other dimensions, apart from coffee. It expects its Teavana business to reach \$3 billion annual sales in the next five years while it also expects to double the size of its food business by 2021.

Finally, Nestle recently acquired the right to market the coffee products of Starbucks outside its shops for \$7.2 billion. Starbucks will use the proceeds to accelerate its share repurchases. In a fortunate turn of events for shareholders, these share repurchases seem likely to accelerate when the stock price is depressed.

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 \$2.41 this year to \$4.40 in 2023.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	26.4	16.0	18.7	22.8	27.5	26.5	27.9	30.2	30.4	27.7	21.3	22.0
Avg. Yld.	----	----	1.0%	1.5%	1.4%	1.4%	1.4%	1.3%	1.4%	1.8%	2.8%	2.4%

Disclosure: This analyst has a long position in the security discussed in this research report.

Starbucks has always enjoyed a premium valuation. As a result, its 10-year average P/E ratio is 25.4 (a time period that includes low price-to-earnings ratios in 2009 and 2010). Starbucks grew EPS from 2010 through 2017 at an 18% annualized rate. This level of growth will not occur over the next decade.

We believe a price-to-earnings ratio of 22 makes sense for a high quality, recession resistant business with double-digit growth prospects in today's market environment. Starbucks is currently trading for a price-to-earnings ratio of 21, just below our expected fair value. We expect valuation multiple expansion to add 0.6% annually to total returns.

Safety, Quality, Competitive Advantage, & Recession Resiliency

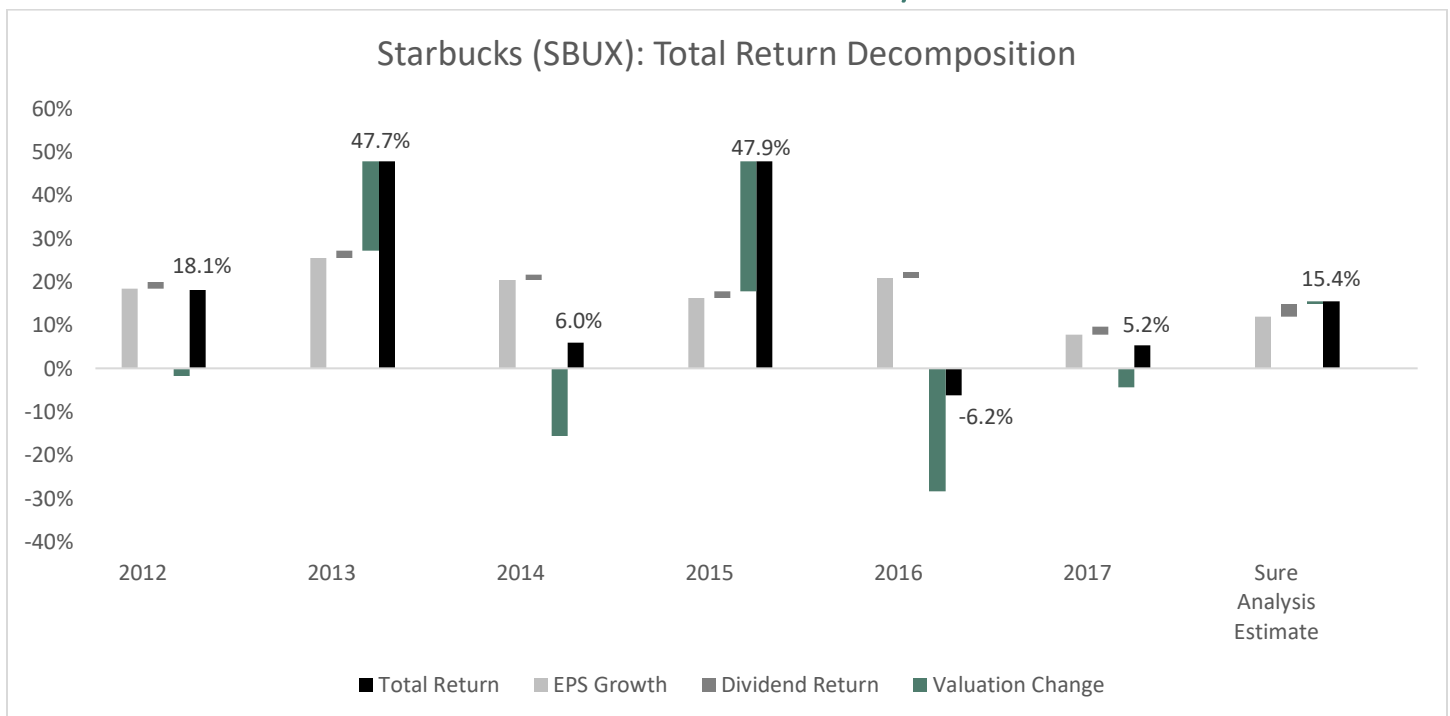
Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	101%	97.7%	98.5%	92.2%	90.8%	73.7%	89.2%	91.6%	89.5%	92.9%	90.0%	90.0%
Debt/A	56.1%	45.2%	42.3%	40.4%	37.8%	61.1%	51.0%	53.1%	58.8%	62.0%	73.1%	70.0%
Int. Cov.	11.6	258.2	44.9	61.1	51.9	303.9	149.8	144.5	141.3	143.5	116.2	60.0
Payout	0%	0%	18.8%	34.2%	37.8%	37.2%	38.2%	40.5%	41.9%	48.5%	59.8%	51.8%
Std. Dev.	42.4%	43.2%	22.1%	21.6%	28.3%	13.4%	14.9%	16.4%	14.5%	14.6%	15.0%	17.0%

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%+ average annual return over the next five years thanks to strong 12% expected earnings-per-share growth, the stock's near 3% yield, and modest valuation gains. Starbucks is a great business trading at a fair price, and earns a buy recommendation today.

Total Return Breakdown by Year



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