

Starbucks Corporation (SBUX)

Updated July 29th, 2020 by Eli Inkrot

Key Metrics

Current Price:	\$78	5 Year CAGR Estimate:	7.2%	Market Cap:	\$90.7 B
Fair Value Price:	\$62	5 Year Growth Estimate:	10.0%	Ex-Dividend Date:	08/06/20
% Fair Value:	126%	5 Year Valuation Multiple Estimate:	-4.5%	Dividend Payment Date:	08/21/20
Dividend Yield:	2.1%	5 Year Price Target	\$99	Years Of Dividend Growth:	10
Dividend Risk Score:	C	Retirement Suitability Score:	D	Last Dividend Increase:	13.9%

Overview & Current Events

Starbucks, which began with a single store in Seattle's Pike Place Market in 1971, now has over 32,000 stores around the world. The company operates under the namesake Starbucks brand, but also holds the Seattle's Best Coffee, Teavana, Evolution Fresh, and Ethos Water brands in its portfolio. The \$91 billion market cap company generated \$26 billion in revenue and \$3.5 billion in profit last year.

On July 28th, 2020 Starbucks announced Q3 fiscal year 2020 results for the period ending June 28th, 2020. (Starbucks fiscal year ends the Sunday closest to September 30th.) For the quarter the company generated net revenue of \$4.2 billion, which was down -38% from Q3 2019 due to the COVID-19 pandemic. Global comparable sales were down -40%, driven by a -51% decrease in comparable transactions, partially offset by a 23% increase in the average ticket. U.S. comparable store sales declined -40%, driven by a -52% decrease in comparable transactions, offset by a 25% increase in the average ticket. Starbucks opened 130 net new stores during the quarter, bringing the total up to 32,180. Adjusted earnings-per-share equaled -\$0.46 compared to a gain of \$0.78 in Q3 2019, reflecting lower sales and retail partner support.

In two previous reports we noted that first more than half of China stores were closed, and then more than half of U.S., Canada, Japan and U.K. stores were closed. In Q3 2020, Starbucks said that approximately 97% of global company-operated stores are now open, including 96% in the U.S. and 99% in China. Starbucks also updated its 2020 guidance, anticipating sales declines of -12% to -17%, opening 300 net new stores in the Americas and 500 net new stores in China and adjusted earnings-per-share in the \$0.83 to \$0.98 range.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	\$0.64	\$0.76	\$0.90	\$1.13	\$1.36	\$1.58	\$1.91	\$2.06	\$2.42	\$2.83	\$0.90	\$4.51
DPS	\$0.12	\$0.26	\$0.34	\$0.42	\$0.52	\$0.64	\$0.80	\$1.00	\$1.26	\$1.44	\$1.64	\$2.40
Shares¹	1,485	1,490	1,499	1,506	1,499	1,485	1,461	1,432	1,309	1,185	1,170	1,170

Starbucks has put together a terrific operating record, growing earnings-per-share by 18% per annum dating back to 2010. Of course, this fantastic growth of the past makes future growth a bit harder to replicate. The company's net profit margin has gone from 5% to 13%, while the company-owned store count has jumped from 8,800 to over 15,000. Somewhat paradoxically, it gets harder and harder to improve as the business becomes more and more impressive.

Today the company is facing tremendous challenges from the COVID-19 pandemic. Demand is down significantly, and financial results are sure to take a hit in the short-term. To this point, we have reduced earnings expectations materially, which could be too optimistic if the pandemic lasts longer than anticipated.

Still, Starbucks has a strong growth trajectory available over the long-term in the way of a growing U.S. and International store count, where the company is still in the early innings of expansion, coupled with pricing power. For valuation purposes we are using \$2.80 in underlying earnings power to go along with a 10% intermediate-term growth rate. We will adjust this if long-term earnings become impaired, but for now we are expecting growth to return.

¹ In millions.

Disclosure: This analyst has no position in the security discussed in this research report and no plans to initiate one in the next 72 hours

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Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	18.7	22.8	27.5	26.5	27.9	30.2	30.4	27.7	23.2	26.6	27.7	22.0
Avg. Yld.	1.0%	1.5%	1.4%	1.4%	1.4%	1.3%	1.4%	1.8%	2.2%	1.9%	2.1%	2.4%

Over the past decade shares of Starbucks have traded hands with an average P/E ratio of about 26 times earnings. However, this was during a time when the company's growth rate was much faster. Moving forward we have presumed a multiple of 22 times earnings, which still implies a premium valuation – reflecting the company's solid growth prospects and overall quality – but note that growth will be more and more difficult to formulate over time. At the current valuation, now trading near 28 times underlying earnings power, there is the possibility of a valuation headwind from this point. Meanwhile, the dividend component is becoming a larger factor for investor returns.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	19%	34%	38%	37%	38%	41%	42%	49%	52%	51%	59%	53%

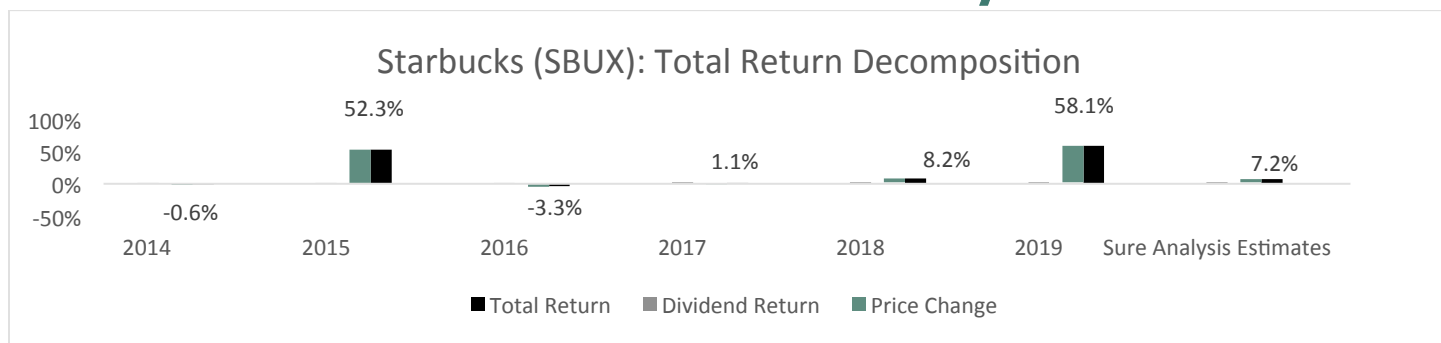
Starbucks sells an addicting product combined with a well-respected brand. This allows Starbucks to sell its coffee at premium prices and generate repeat business from customers. Moreover, the company is recession resistant. From fiscal year 2007 to 2008, earnings-per-share fell -18%, before increasing by 11% and 60% in the next two years; earnings have climbed higher every year since. That being said, we expect a significantly down year for 2020.

At the end of Q3 2020, Starbucks held \$4.0 billion in cash and equivalents, \$7.6 billion in current assets and \$29.1 billion in total assets against \$8.0 billion in current liabilities and \$37.8 billion in total liabilities. Long-term debt stood at \$14.6 billion against underlying earnings power north of \$3 billion annually. While the dividend payout ratio has increased significantly (from 0% in 2009 to over half of earnings) Starbucks continues to maintain a reasonable financial position.

Final Thoughts & Recommendation

Shares are more or less unchanged since our last report. Starbucks is one of those companies that you would love to own, with a terrific past, strong financial position, excellent brand and clear growth path ahead. Of course, the problem is that everyone knows about these great attributes, resulting in a share price that has been bid up accordingly. This really equalizes the value proposition and turns a standout business into a mediocre investment thesis when it comes to anticipated returns. We forecast 7.2% annual returns, comprising of a 10% intermediate-term growth rate and the company's 2.1% dividend yield offset by a valuation headwind. We are reiterating our hold rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	10707	11700	13277	14867	16448	19163	21316	22387	24720	26509
Gross Profit	6291	6785	7464	8485	9589	11375	12805	13349	14545	7488
Gross Margin	58.8%	58.0%	56.2%	57.1%	58.3%	59.4%	60.1%	59.6%	58.8%	28.2%
SG&A Exp.	4177	749	801	938	991	1197	1361	1393	1759	1824
D&A Exp.	541	550	581	656	748	934	1030	1067	1306	1449
Operating Profit	1324	1525	1787	2207	2793	3351	3854	3897	3807	3916
Operating Margin	12.4%	13.0%	13.5%	14.8%	17.0%	17.5%	18.1%	17.4%	15.4%	14.8%
Net Profit	946	1246	1384	8	2068	2757	2818	2885	4518	3599
Net Margin	8.8%	10.6%	10.4%	0.1%	12.6%	14.4%	13.2%	12.9%	18.3%	13.6%
Free Cash Flow	1259	1081	894	1757	-553	2445	3135	2655	9961	3240
Income Tax	489	563	674	-239	1092	1144	1380	1433	1262	872

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	6386	7360	8219	11517	10753	12416	14313	14366	24156	19220
Cash & Equivalents	1164	1148	1189	2576	1708	1530	2129	2462	8756	2687
Accounts Receivable	303	387	486	561	631	719	769	870	693	879
Inventories	543	966	1242	1111	1091	1306	1379	1364	1401	1529
Goodwill & Int. Ass.	333	434	543	1138	1130	2096	2236	1981	4584	4273
Total Liabilities	2704	2973	3105	7034	5479	6597	8422	8909	22981	25451
Accounts Payable	283	540	398	492	534	684	731	783	1179	1190
Long-Term Debt	549	550	550	1299	2048	2348	3585	3933	9440	11167
Shareholder's Equity	3675	4385	5109	4480	5272	5818	5884	5450	1170	-6232
D/E Ratio	0.15	0.13	0.11	0.29	0.39	0.40	0.61	0.72	8.07	-1.79

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	15.8%	18.1%	17.8%	0.1%	18.6%	23.8%	21.1%	20.1%	23.5%	16.6%
Return on Equity	28.1%	30.9%	29.2%	0.2%	42.4%	49.7%	48.2%	50.9%	137%	---
ROIC	24.1%	27.2%	26.1%	0.1%	31.6%	35.6%	31.9%	30.6%	45.2%	46.3%
Shares Out.	1,485	1,490	1,499	1,506	1,499	1,485	1,461	1,432	1,309	1,185
Revenue/Share	7.01	7.60	8.59	9.75	10.78	12.66	14.34	15.32	17.73	21.50
FCF/Share	0.82	0.70	0.58	1.15	-0.36	1.62	2.11	1.82	7.14	2.63

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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