First Cut Stock Study Report

Company Name:	Starbucks	**Ticker:**	SBUX
Date of Study:	7/30/2015	**Price:**	$ 57.51
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Discuss why you consider this to be a high quality, growth company that should be investigated further. Please include comments on historical sales and EPS growth, pre-tax profit margin, return on equity, and debt.

Other than the decline in 2013 EPS, SBUX has demonstrated fairly consistent and steady growth over the past 10 years. Sales have grown at a rate of 9.7% over the past 10 years, which includes the sales decline during the Great Recession in 2008-2009. Since 2010 sales and EPS have grown at 11.6% and 20.8%, respectively. Pre-tax profit margins have been steadily increasing since 2008. The 5-year average is 16.2% and the pre-tax profit margin on the most recent 4 quarters (ending 6/15) is 21.3%. Excluding 2013 th % Earned on Equity has averaged over 29% over the past 5 years. Debt levels are up, but they are at a manageable level, 28% debt to capital in FY 2014. Interest coverage is over 58, indicating that SBUX can easily handle the debt obligation.

In FY 2013 SBUX had a litigation charge of $2.76B to settle the arbitration with Kraft regarding Starbucks firing Kraft as the distributor of packaged coffee to grocery chains prior to the conclusion of their contract. Based on my research I feel this was a one-time event that is not likely to recur.

Briefly describe how the company makes money:

(Source: 2014 10-K) Starbucks is the premier roaster, marketer and retailer of specialty coffee in the world, operating in 65 countries. Revenue is generated through company-operated stores (generating 79% of total revenue), licensed stores (10%), consumer packaged goods ("CPG"; 8%) and foodservice operations (3%). As of FY 2014, SBUX had 21,366 total stores, which were evenly distributed between Company-operated and licensed stores. Revenue from company-operated stores accounted for 79% of total net revenues during fiscal 2014. Revenues from licensed stores accounted for 10% of total net revenues in fiscal 2014. Licensed stores generally have a higher operating margin than company-operated stores. Under the licensed model, Starbucks receives a reduced share of the total store revenues, but this is more than offset by the reduction in its share of costs as these are primarily incurred by the licensee.

72.8% of the total 2014 revenue was generated in the Americas.

Projected growth rate for sales: 13**%**
Why did you select this rate? Discuss from where future growth will come.

Growth of revenue will come from 3 sources: increased same store sales, new stores and acquisitions. A large proportion (half or more) of the new stores are planned to be in the China/Asia Pacific segment.

My sales growth estimate of 13% is a combination of about 6% new store growth, 6% same store sales growth and 1% from acquisitions.

Projected growth rate for earnings per share: 12**%**
Why did you select this rate?

I used the Preferred Procedure to make the EPS growth estimate using the following values:
Pre-tax profit margin remaining steady at the current 21% (trend is up)
Taxes remaining steady at 34.1% (tax rate from 2014)
Number of shares outstanding remaining at current level of 1,515.7M (trend is down)

The preferred procedure calculation results in 11.8%, which I rounded up to 12%.

Projected High P/E: 28.5
Why did you select this value?

After removing the 2013 high P/E as an outlier, the average of the remaining four years is 28.5. This seems reasonable and is the value seelcted for the projected high P/E.

Projected Low P/E: 19
Why did you select this value?

2013 was removed as an outlier from the low P/E values. The remaining numbers appear to be trending upward, but I stayed with the average (rounded up).

Projected Low Price: $33.6
Why did you select this value?

After adjusting the low EPS value to reflect the most recent 4 quarters (TTM) EPS, the 4B(a) calculation (low P/E x low EPS) resulted in a reasonable low price.

At the current price, the stock is a (check one):

☐**Buy** or ☒**Hold** or ☐**Sell**

At the current price, the upside-downside ratio is: 1.3 **to 1**

Compound Annual Return – Using Forecast High P/E: 10.4**%**

Your final recommendation (check one):

☐**Buy** or ☒**Hold** or ☐**Sell**

Explain:

One more minor judgment to be made is selecting the future %payout. The average of the values from 2011, 2012 and 2014 results in 36.2% and this is in line with the current %payout of 36.1%. I selected 36% for the %payout projection in section 5 of the SSG.

Starbucks appears to be a high quality company. At the current price the current P/E is 32 and the stock appears to be overvalued.

Starbucks is a good candidate for a watch list. Based on the prepared SSG, SBUX would be a buy around $47.

Company Starbucks Corp		Date 7/29/2015	
Prepared by BI		Data taken from BI Stock Data	
Where traded NAS		Industry Restaurants	
Capitalization --- Outstanding Amounts		Reference	

		% Insiders	% Institution
Preferred ($M)	0.0		
Diluted Shares (M)	1,515.7	1.3	75.5

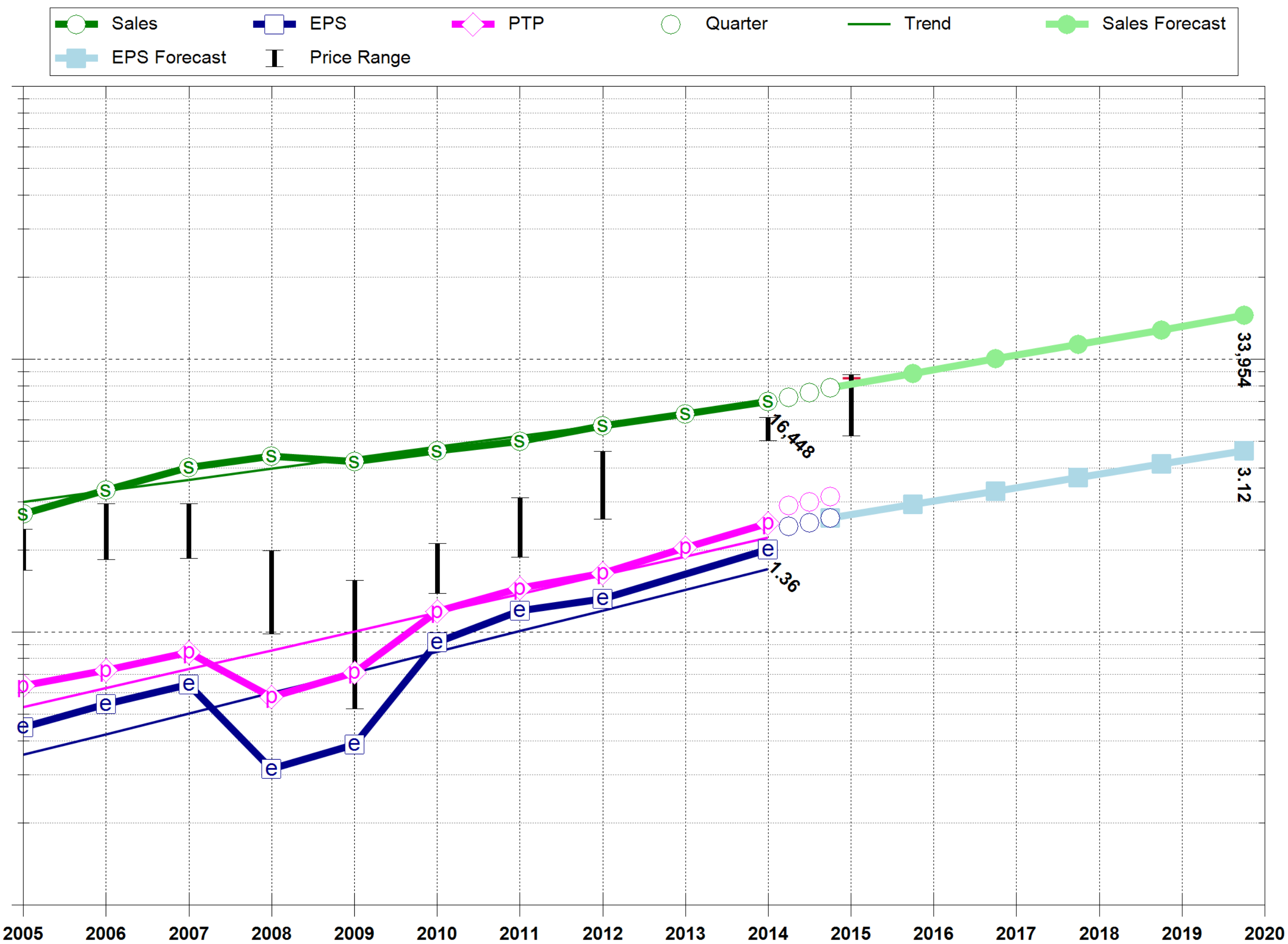
Debt ($M)	0.0	% to Tot Cap	0.0	% Pot Dil	0.0

Stock Selection Guide

Symbol: SBUX

1 VISUAL ANALYSIS of Sales, Earnings, and Price

FY2015 QuarterEnding (06/15)	Sales ($M)	Earnings Per Share
Latest Quarter	4,881.2	0.41
Year Ago Quarter	4,153.7	0.34
Percentage Change	17.5%	22.6%



(1) Historical Sales Growth	9.7%	(3) Historical Earnings Per Share Growth	19.0%
(2) Estimated Future Sales Growth	13.0%	(4) Estimated Future Earnings Per Share Growth	12.0%

2 EVALUATING Management

Starbucks Corp

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Last 5 Year Avg.
Pre-tax Profit on Sales	12.5%	11.6%	11.2%	7.0%	9.1%	13.9%	15.5%	15.5%	17.2%	19.1%	16.2%
% Earned on Equity	22.3%	22.2%	27.3%	12.6%	12.8%	24.9%	27.5%	24.9%	0.1%	40.1%	23.5%
% Debt To Capital	11.8%	24.0%	35.6%	33.7%	15.3%	13.0%	11.1%	9.7%	22.5%	28.0%	16.9%

3 PRICE-EARNINGS HISTORY as an indicator of the future

This shows how stock prices have fluctuated with earnings and dividends. It is building block for translating earnings into future stock prices.

PRESENT PRICE 57.5 **HIGH THIS YEAR** 59.30 **LOW THIS YEAR** 35.40

		A	B	C	D	E	F	G	H
	Year	**Price**		**Earnings**	**Price Earnings Ratio**		**Dividend**	**% Payout**	**% High Yield**
		High	Low	Per Share	High A / C	Low B / C	Per Share	F / C * 100	F / B * 100
1	2010	14.3	9.3	0.62	23.0	15.1	0.12	18.6	1.2
2	2011	21.0	12.7	0.81	26.0	15.7	0.26	32.1	2.0
3	2012	31.0	17.6	0.90	34.6	19.6	0.34	38.0	1.9
4	2013	38.9	22.1	0.01	7,784.5	4,427.0	0.42	8,400.0	1.9
5	2014	41.3	34.0	1.36	30.4	25.1	0.52	38.4	1.5
	AVERAGE		19.1		28.5	18.9		36.2	
	CURRENT/TTM			1.77			0.64	36.1	
	AVERAGE PRICE EARNINGS RATIO 23.7					CURRENT PRICE EARNINGS RATIO 32.4			

4 EVALUATING RISK and REWARD over the next 5 years

Assuming one recession and one business boom every 5 years, calculations are made of how high and how low the stock might sell. The upside-downside ratio is the key to evaluating risk and reward.

A HIGH PRICE - NEXT 5 YEARS

Avg. High P/E 28.50 X Estimate High Earnings/Share 3.12 = Forecasted High Price $ 88.9

B LOW PRICE - NEXT 5 YEARS

(a) Avg. Low P/E 19.00 X Estimate Low Earnings/Share 1.77 = Forecasted Low Price $ 33.6

(b) Avg. Low Price of Last 5 Years 19.1

(c) Recent Market Low Price 22.14

(d) Price Dividend Will Support $\frac{\text{Present Dividend}}{\text{High Yield}} = \frac{0.640}{1.50\%} = 42.7$

Selected Forecasted Low Price $ 33.6

C ZONING using 25%-50%-25%

Forecasted High Price 88.9 Minus Forecasted Low Price 33.6 = 55.3 Range. 25% of Range 13.8

Buy Zone	33.6	to	47.4
Hold Zone	47.4	to	75.1
Sell Zone	75.1	to	88.9

Present Market Price of 57.51 is in the **Hold** Zone

D UPSIDE DOWNSIDE RATIO (POTENTIAL GAIN VS. RISK OR LOSS)

$\frac{\text{High Price}}{\text{Present Price}} \frac{88.9}{57.51} \frac{\text{Minus Present Price}}{\text{Minus Low Price}} \frac{57.51}{33.6} = \frac{31.41}{23.91} = 1.3$ To 1

E PRICE TARGET **(Note: This shows the potential market price appreciation over the next five years in simple interest terms.)**

$\frac{\text{High Price}}{\text{Present Market Price}} \frac{88.9}{57.51} = 1.55 \times 100 = 154.62 - 100 = 54.6$ % Appreciation

5 5-YEAR POTENTIAL

This combines price appreciation with dividend yield to get an estimate of total return. It provides a standard for comparing income and growth stocks.

A $\frac{\text{Present Full Year's Dividend \$}}{\text{Present Price of Stock}} \frac{0.64}{57.51} = 0.01 = 1.1\ \%$ Present Yield

B AVERAGE YIELD - USING FORECAST HIGH P/E

$\frac{\text{Avg. \% Payout}}{\text{Forecast High PE}} = \frac{36.0\ \%}{28.50} = 1.3\ \%$

AVERAGE YIELD - USING FORECAST AVERAGE P/E

$\frac{\text{Avg. \% Payout}}{\text{Forecast Average PE}} = \frac{36.0\ \%}{23.75} = 1.5\ \%$

C COMPOUND ANNUAL RETURN - USING FORECAST HIGH P/E

Annualized Appreciation	9.1 %
Average Yield	1.3 %
Annualized Rate of Return	10.4 %

COMPOUND ANNUAL RETURN - USING FORECAST AVG P/E

Annualized Appreciation	5.2 %
Average Yield	1.5 %
Annualized Rate of Return	6.7 %