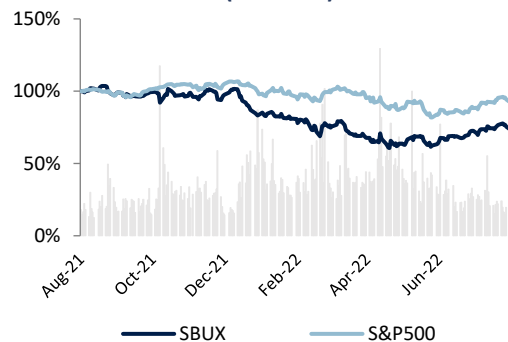


**Recommendation Buy The Perfect Blend**
**Analysts**

Timothy Hoon	Lead Analyst, Equity Research
Azel Ang	Analyst, Equity Research
Dominic Teo	Analyst, Equity Research

**Basic Information**

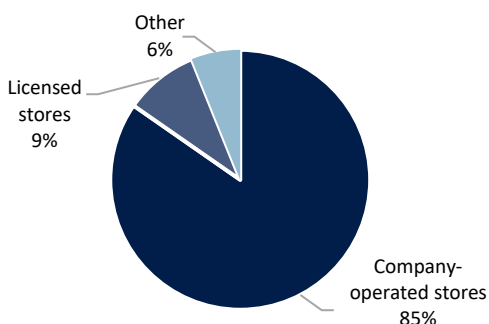
Current Price	\$84.95
Target Price	\$99.50
+/- Potential	+17.12%
Exchange	NASDAQ
Ticker	SBUX
Market Capitalisation	\$99.7bn
Shares Outstanding	\$1.1mn
52-Week Trading	\$68.39 - \$120.76
Average Volume	7.3bn
Fiscal Year End	31 October 2022
Short Interest	1.16%

**1Y Price vs S&P500 (Rebased)**

**Key Executives**

Schultz, Howard D.	CEO, Founder & Director
Ruggeri, Rachel	CFO
Culver, John W.	COO

**Major Shareholders**

The Vanguard Group, Inc.	8.92%
BlackRock, Inc.	6.44%
State Street Global Advisors, Inc.	3.88%

**Fig 1: Revenue Breakdown by Segment (%)**


Source: Company Filings

**Company Overview**

Starbucks Corporation's core business offering is their operation as roasters, marketers, and retailers of speciality coffee. Founded in 1971, they are based in Seattle, Washington of which their global outreach has grown to 3 key segments, namely, North America, International and Channel Development. Starbucks's primary offers beverages (coffee and tea) and some food products (pastries and sandwiches).

**Key Revenue Segments:** SBUX operates 34,948 stores globally, of which 51% is company-operated and the 49% licensed. SBUX' key revenue comes from company-operated and license-operated stores, which accounts for 85% of the total net revenue, for the fiscal year 2021.

**Cost Structure:** SBUX's main cost drivers are i) product and distribution costs, ii) store operating expenses iii) General Administrative Expenses which comprises of 35.6%, 48.6%, 7.9% of the total operating expenses respectively.

**Industry Outlook**

Strong and steady growth is expected in the Coffee industry, revenue is expected to be \$433.60bn in 2022. The market is expected to growth at a CAGR of 7.64% to 2025. Speciality Coffee Shops markets are set to grow at a CAGR of 13.02% to 2026, driven by the increasing consumption of coffee.

**Trend Towards Home Consumption:** A large portion of the coffee segment in the post pandemic era has been attributed to home consumption, with the increase in preference for convenience in the comfort of our own homes. Reduction in on-the-go consumption has spurred many to invest in home appliances such as espresso machines. SBUX currently remains as the leading ready-to-drink coffee brand in the US, with market share of roughly 28%, effectively capturing this trend.

**Shifting Consumer Preference Towards Cold Coffee Beverage:** Cold coffee beverage saw massive growth in the last few years. On average, iced coffee grew 19% and cold brew grew 245% over the last 4 years. The growth is largely attributed to Generation Z and Millennials preference in cold beverage. Furthermore, the cold brew coffee market is expected to grow at a CAGR of 25.1% up to 2025.

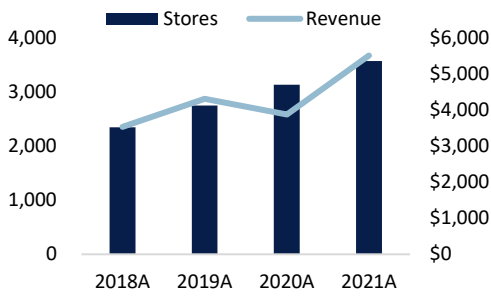
**Investment Thesis**
**Long-Term Growth Potential in China**

In FY2021, China generates 42% of total revenue for the China Asia Pacific region. China's expansion plans include 600 net new stores per year, reaching 6,000 stores and 100 additional cities this year (Fig 2). The long-term potential for Starbucks in China remains bright, with the potential to be larger than the US business overtime. We believe that SBUX is going to be successful in China due to its third-place model, digital assets, well-thought-out localisation of products, supply chain, and the SBUX business culture that have been invested and nurtured for over 20 years in China. SBUX differentiates itself from local competitors such as Luckin Coffee through the unique in-store experience that SBUX offers, such as open format sitting areas that are laid out to welcome crowds and lounging, taking into account the Chinese values and community culture as compared to Luckin with stores based in offices buildings. Furthermore, SBUX's position as a premium coffee brand is also appealing to the Chinese masses who places an emphasis on reputation and status, allowing it to be the dominant player in the China ground coffee market with a market share of over 36%, with Luckin coming in second at a distant 7.8%.

**Diversification of Product Mix Towards Cold Beverages**

The global coffee cold brew market is slated to reach \$1.63bn by 2025, with a CAGR of 25.1%. The cold beverage product mix anchored by cold brew and refreshers has

**Fig 2: Net Revenue (US\$m) and No. Of Stores in Starbucks China**



Source: Company Filings, Statista

been a runaway success; cold beverages now represent nearly 75% of SBUX sales, up from 45% a few years ago. The cold beverage is a key strategic advantage particularly in warmer countries, as it is generally harder to substitute by in house coffee. SBUX is diversifying its cold beverages with great innovation through unique drinks. We believe that long term, the cold beverages will drive sustained customer loyalty, store productivity, and optionality in the packaged goods channel.

**Enhanced Starbucks Experience with a Digitalisation Push**

The pandemic has changed consumer behaviour with lockdowns and remote working, creating a change in shopping habits and shift in media consumptions. Market players are pivoting from traditional consumer journeys and incorporating digital elements into their customer journeys. Even pre-pandemic, 80% of SBUX customers already actively used their app for ‘grab and go’ orders. By integrating digital engagement and creating a seamless customer experience whenever a customer interacts with the SBUX brand, SBUX continues to differentiate itself by providing its customers with a unique and distinct experience regardless of their digital inclination. This can be observed in the recently introduced new store formats, such as the Starbucks Pickup®, which has enhanced the on-the-go customer experience in major metropolitan areas in the U.S.

**Fig 3: SWOT Analysis**

**Strengths:**

- Strong Global Brand reputation
- Quality assurance of products and services
- Strong company culture that invests in partners (employees)

**Weakness:**

- Price hikes due to uncontrollable supply factors
- Licensees and third-party providers with possible unsatisfactory performance

**Opportunities:**

- Further expansion in international markets, especially China
- Expanding ready-to-drink coffee market

**Threats:**

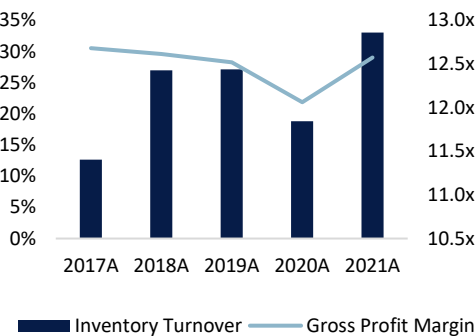
- Unpredictable coffee bean prices
- Competitive brands with similar and cheaper products

Source: Team Analysis

**Financial Takeaways**

**Stable Profitability Margins:** Over the past 5 years, SBUX has grown at a CAGR of 5% whilst its profitability margins have remained stable aside from the pandemic years. The post pandemic recovery has also been evident as can be seen from the 2021 revenue and is supported by the 2022 quarterly results. Gross profit margins have been steadily above 13.03% which is above the median of 9.03%, compared to their competitors. The Returns on Assets for SBUX is also significantly higher than that of its competitors, at 10.31% compared to the competitor median of 6.68%.

**Fig 4: Gross Profit Margin & Inventory Turnover**



Source: Company Filings

**Healthy Inventory Turnover Ratio:** SBUX’s inventory turnover ratio generally lies between 10x to 12.5x which indicates that SBUX moves inventory out quickly, implying that sales are good and restocks is required on a frequent basis. This robust inventory management system is synonymous with improvements made in SBUX’s digitization of its operations.

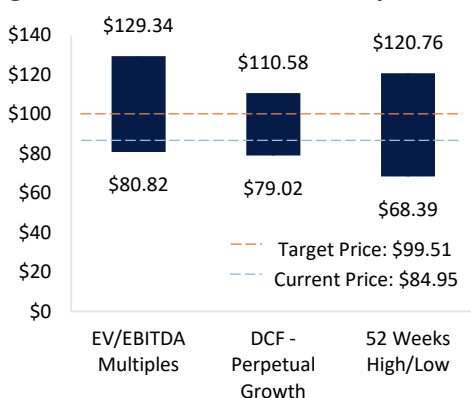
**Robust Unlevered Free Cash Flows:** SBUX’s unlevered FCF of \$4.84bn in FY2021 is appealing to its stakeholders as it shows that the firm is proficient in managing its financial obligations. Also, SBUX’s FCF has been historically observed as an ongoing positive trend less the pandemic affected year and is forecasted to continue growing to \$5.38bn by FY2026.

**Valuation**

**DCF Valuation:** We employed a 5-year DCF model with Perpetual Growth Method to attain our Target price of \$99.50 a 17.12% upside from current price. For our valuation, we used a 3% terminal growth rate and a calculated WACC of 7.56%.

**Relative Valuation:** We utilised large quick serve restaurants EV/EBITDA as it best reflects SBUX’s business currently. Based on our analysis, SBUX should trade at multiples around or even above the 75<sup>th</sup> percentile due to its bigger market capitalization among its peers. The implied share price range is \$80.82 to \$129.34 (Fig 5) with an EV/EBITDA of 18.9x, which supports our buy recommendation.

**Fig 5: Valuation Football Field Analysis**



Source: Team Analysis

**Scenario Analysis:** Our bull case, with an estimated revenue growth of 13%, forecasts SBUX at \$110.58 (+30.17%). On the other hand, our bear case, with an estimated revenue growth of 4%, forecasts a share price of \$79.02 (-6.98%).

The assumption for our bull case is whereby SBUX continues to dominate and gain an even bigger share of the China coffee market while simultaneously capturing all the ongoing and upcoming beverages and coffee consumption trends internationally. On the flip side, the assumption made for the bear case is whereby SBUX expansion in China fails to take off alongside a sudden change in coffee beverages trend that SBUX is not able to capture, which we believe is unlikely to be the case given its adaptability thus far.

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