QUO VADIS
CAPITAL
Proprietary Structural Analysis & Forecasting

Starbucks (SBUX): Secret Menu

July 2 2018

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An earlier version of this presentation was given at ValueX Vail on June 28, 2018

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Presentation Outline

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Time to Look at Starbucks:

Shares have underperformed over the past two years as comps slowed and valuation contracted. The stock tanked in the last week:

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What happened?

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Quick Summary of Current Issues:

The following have contributed to the stock's underperformance:

- Same-store sales have slowed
- Guidance has been too aggressive
- U.S. market may be getting more competitive and is maturing
- Frappuccino product cycle rolled over
- Labor cost pressure in the U.S.
- Confusing messaging on China around delivery SNAFU
- Negative press around bias incident, too much politics
- Howard Schultz leaving, CFO just announced retirement
- Complexity modeling portfolio actions (divestitures and acquisitions)

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We are not going to address any of these issues*

Rather, the focus of this presentation is to quantify, as best as possible, the long-term impact of:

1) Shifting growth to China and
2) The company's capital return program

Investment case to prove:

World-class franchise trading at 5-year trough valuations with growth shifting to an ROIC-accretive market and about to embark on a massive capital return program

* This is not a statement that these issues are irrelevant

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Step 1:

Quantify current and near-term importance of China and other segments to EBIT

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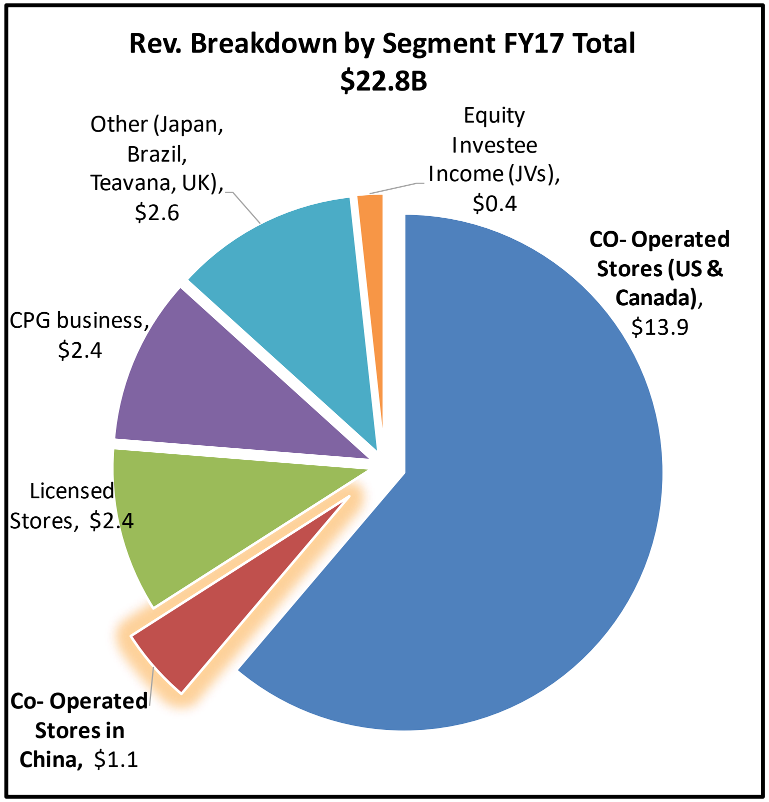
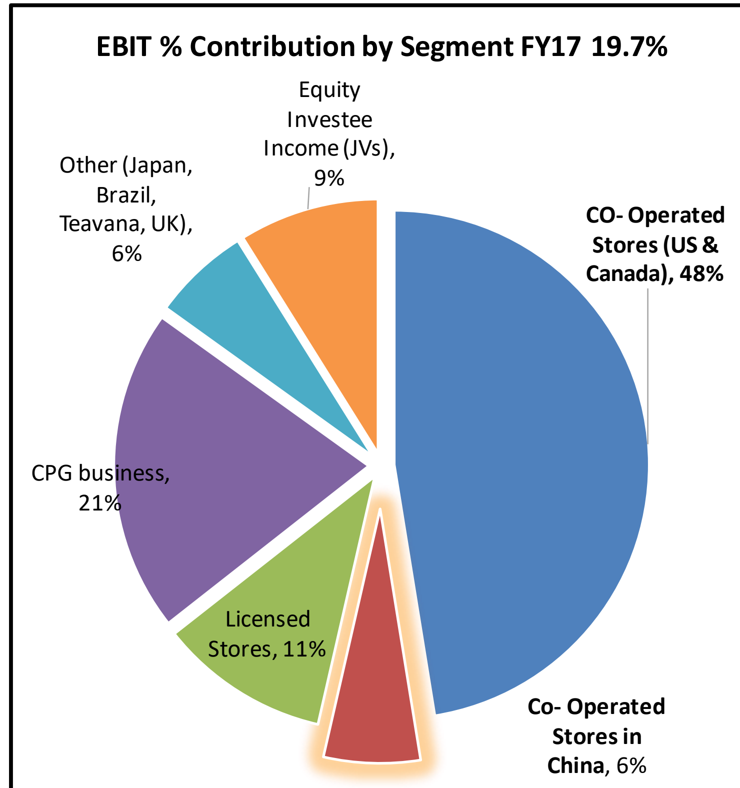
Looking back: In FY17 Company-operated North American stores were 48% of EBIT and China only 6%





EPS	**$2.07**
Free cash flow per share	**$1.82**
Dividends per share	**$1.05**

Source: Company reports, Quo Vadis Capital, Inc. estimates

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The Composition of the Business is Changing

Over the last two years SBUX:

- **Buys out its East China JV Partner**
- **Sells Tazo Tea brand to Unilever**
- **Shuts all Teavana branded stores**
- **Sells its equity interest in its Singapore stores and Taiwan locations**
- **Fully licenses Brazil**
- **Sells its branded consumer products business to Nestle for $7B (deal to close near start of FY19)**

And other actions

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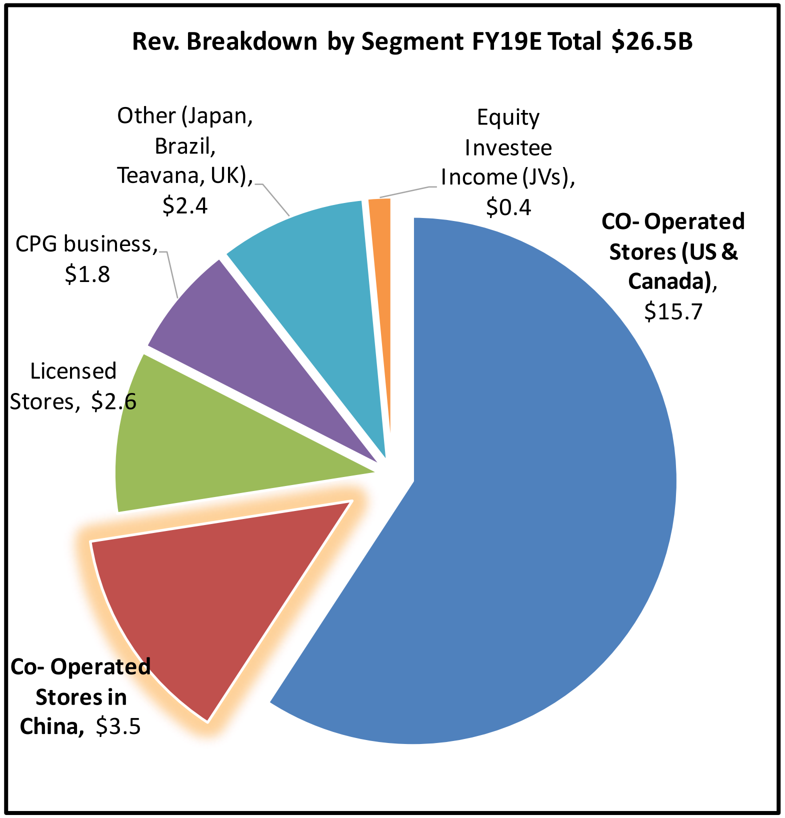
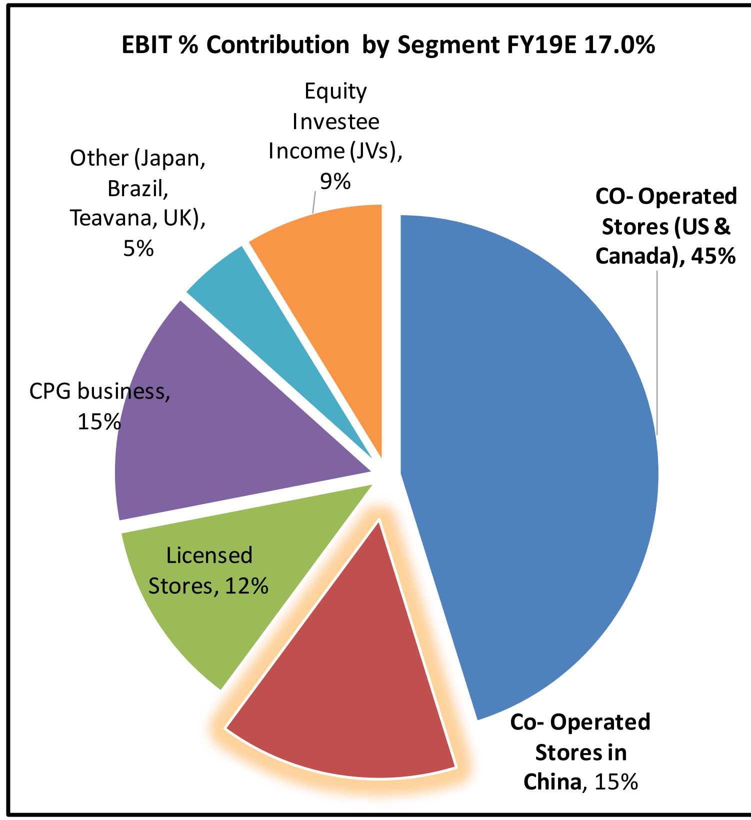
Consequently, next year (FY19E) China will grow to $3.5B in Revs and represent 15% of total company EBIT





EPS	**$2.55**
Free cash flow per share	**$2.67**
Dividends per share	**$1.46**

Source: Company reports, Quo Vadis Capital, Inc. estimates

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But you might ask:

So China is going to 15% of EBIT by next year from 6% back in FY17. It's still small. Why should we care?

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Step 2:

Establish why China matters

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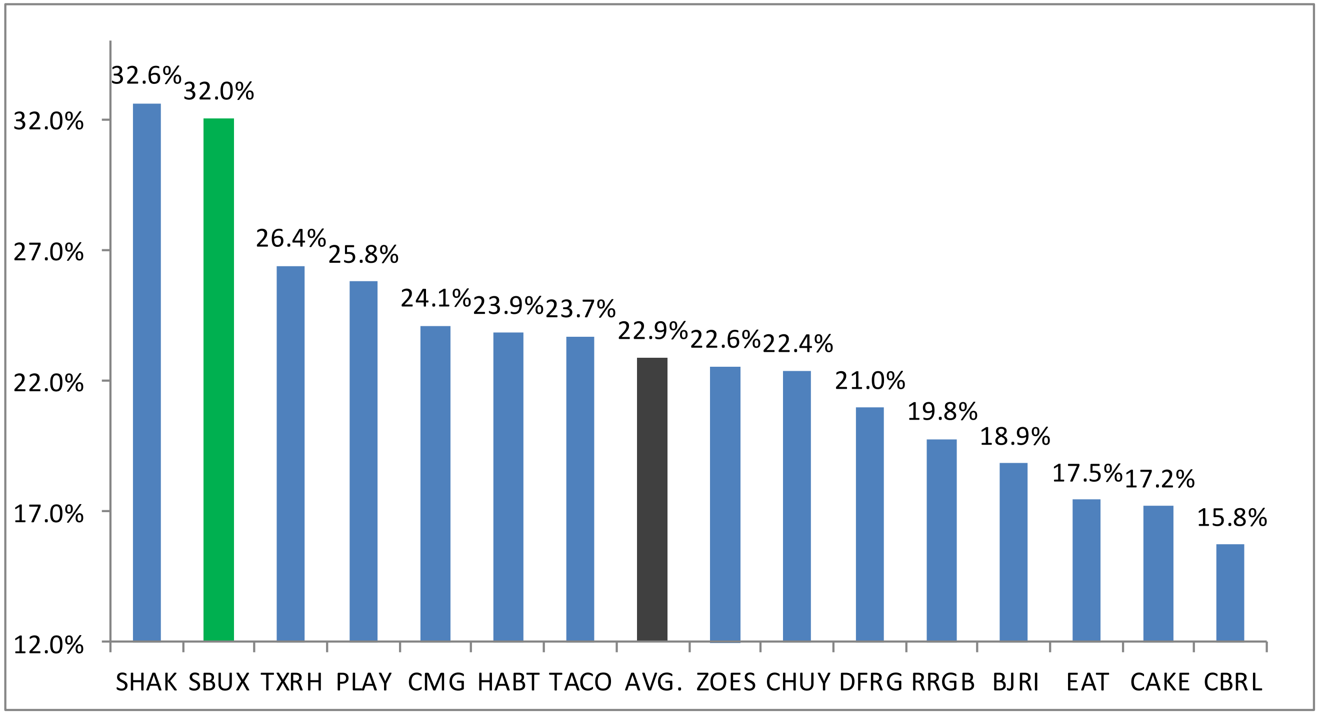
First Some Context:

SBUX ROIC at the store level is among the best in the industry:

Estimated Average Restaurant-Level Lease-adj. ROIC TTM 1Q18



Source: Company Reports & Quo Vadis Capital, Inc. estimates; PLAY and CBRL use Jan YE

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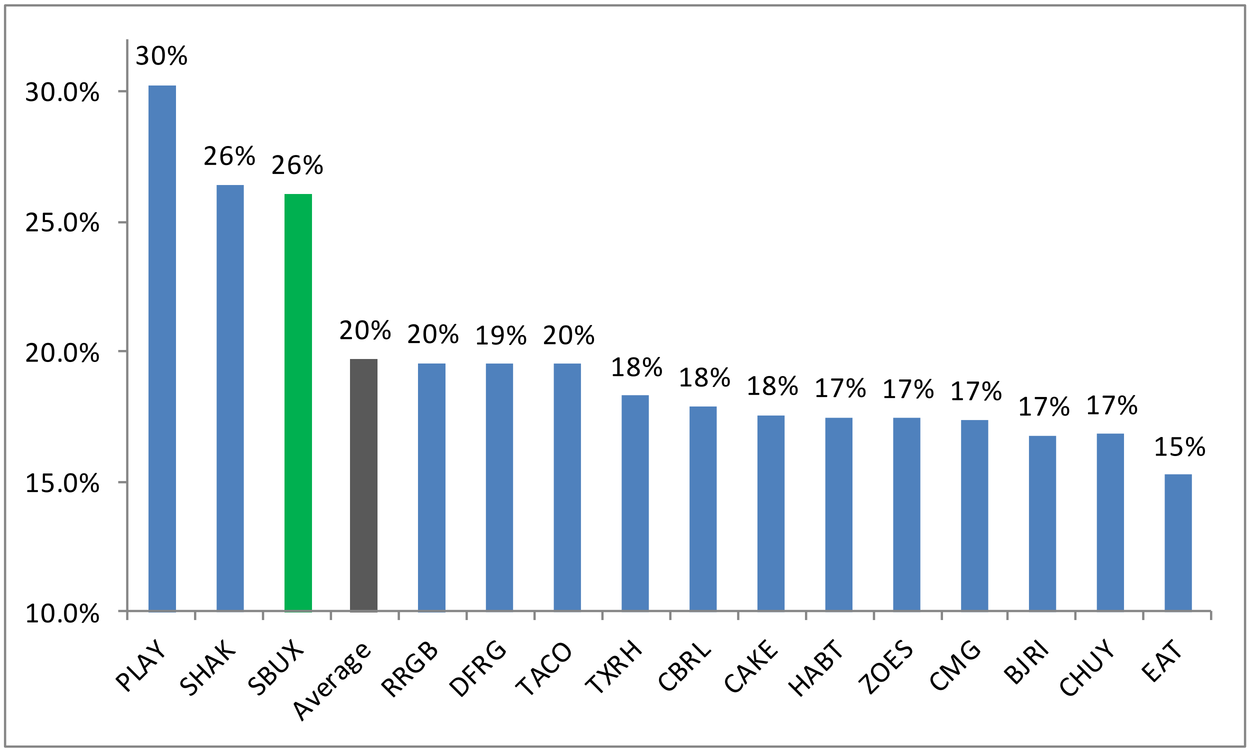
First Some Context:

This is due to lower capital requirements vs. other restaurants (no kitchen) and high margins of beverages (coffee)

TTM Restaurant Level Margins Year Ended with June 2018



Source: Company Reports & Quo Vadis Capital, Inc. estimates

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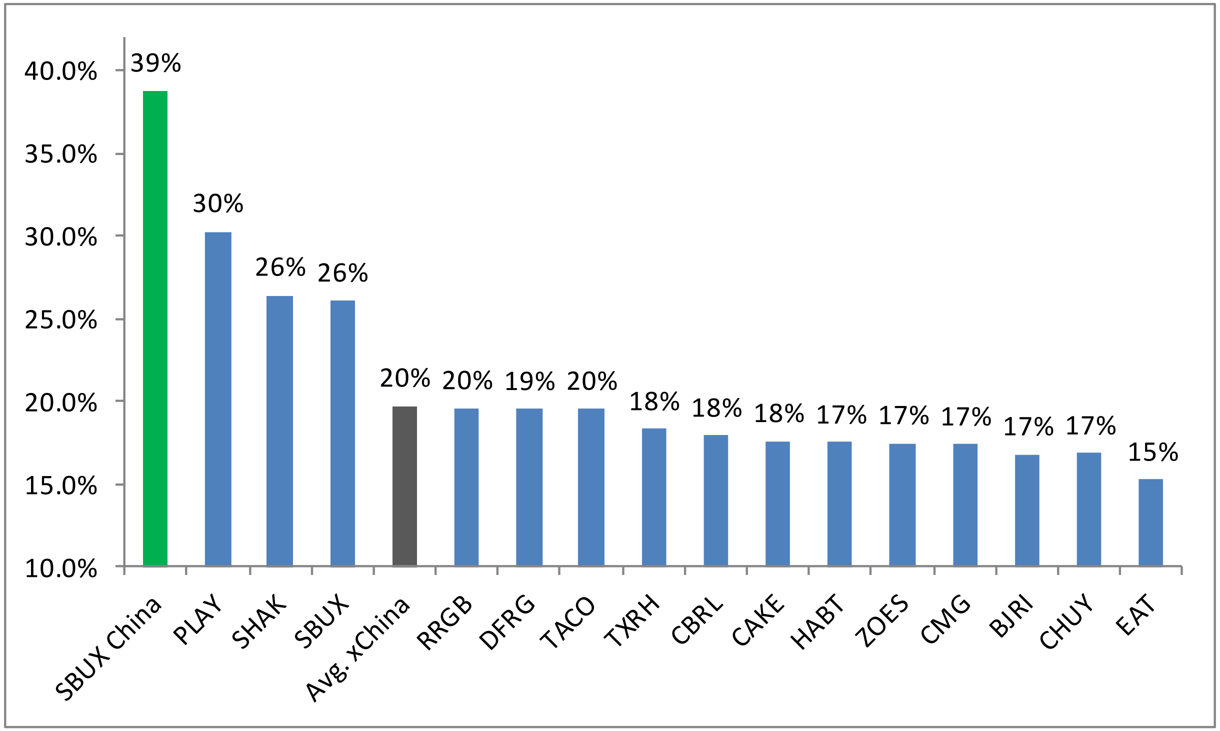
As good as SBUX is overall, Its Chinese stores are something else entirely:

Restaurant level margins in China are 1300 bps (!) higher than SBUX's consolidated average due to lower labor and occupancy costs

TTM Restaurant Level Margins Year Ended with June 2018



Source: Company Reports & Quo Vadis Capital, Inc. estimates

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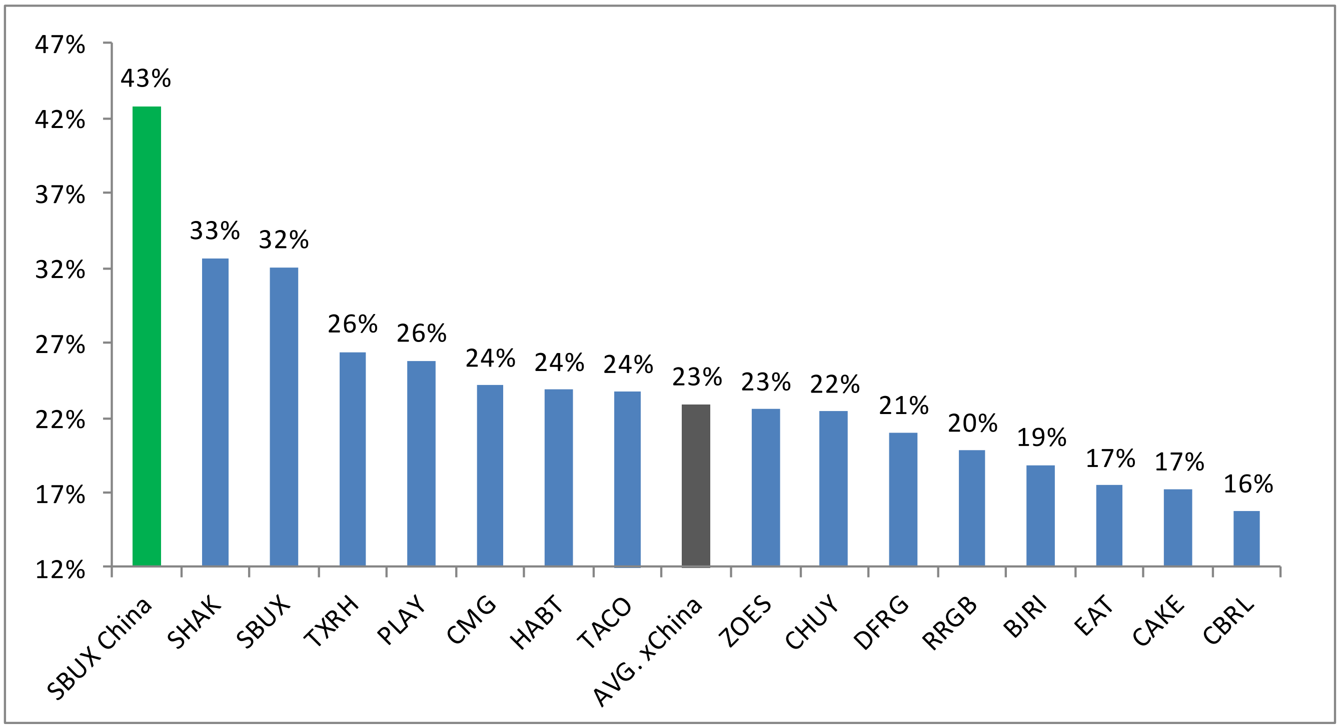
As good as SBUX is overall, Its Chinese stores are something else entirely:

Restaurant level ROIC in China is estimated to be 1100 bps (!) above SBUX's consolidated average:

Estimated Average Restaurant-Level Lease-adj. ROIC TTM 1Q18



Source: Company Reports & Quo Vadis Capital, Inc. estimates; PLAY and CBRL use Jan YE

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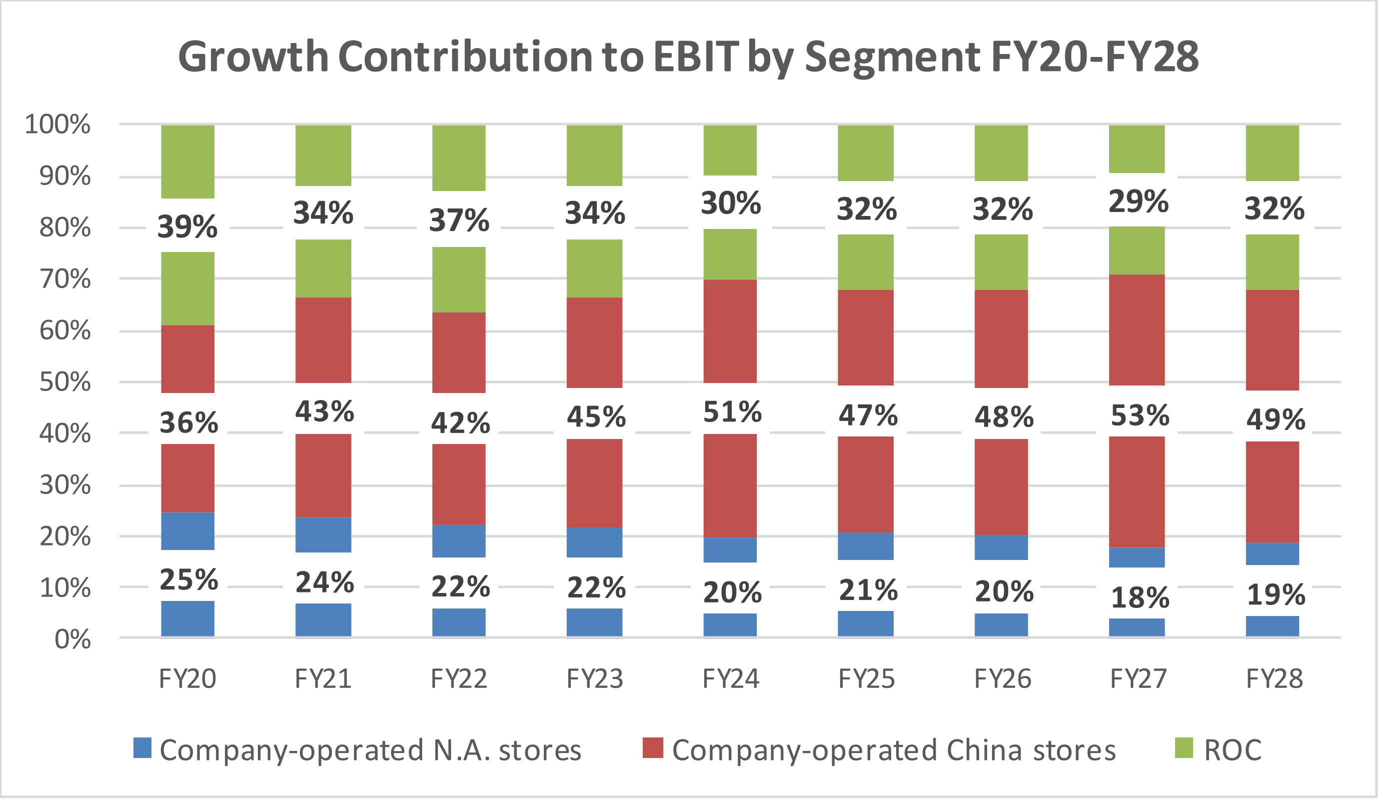
Further, despite its size today, we estimate **China is the largest driver of EBIT Growth** Going forward

Over FY20-FY28, China will contribute almost half of EBIT growth while company-operated N.A. stores will generate only 20%



Source: Company reports, Quo Vadis Capital, Inc. estimates

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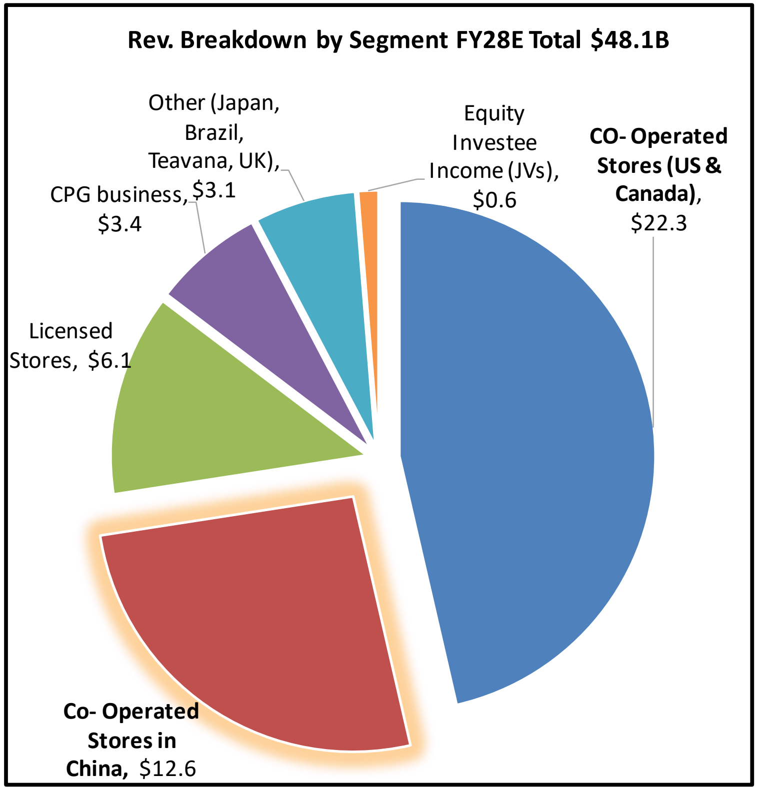
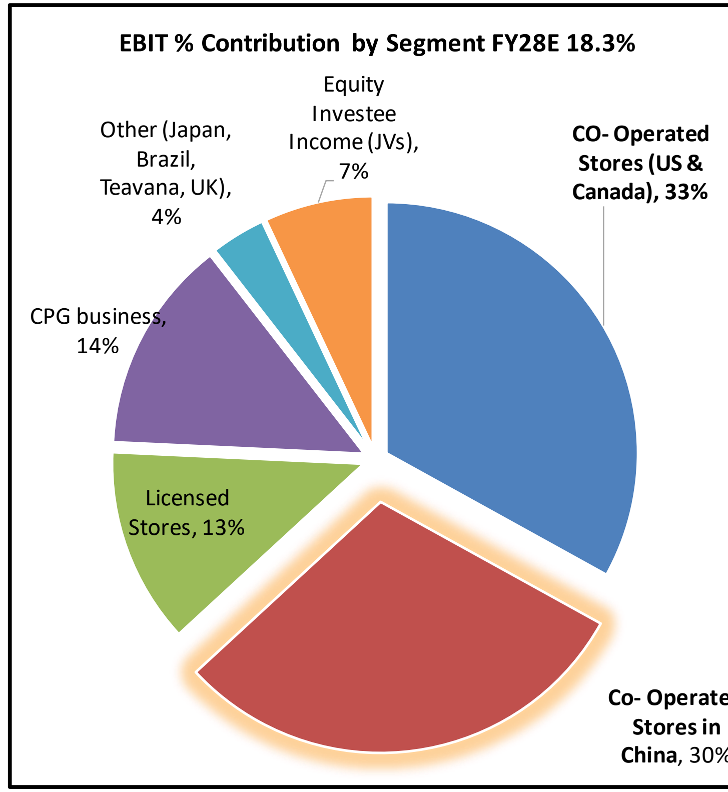
By FY28 China will have nearly as many stores as North America and produce an estimated 30% of EBIT





EPS	**$7.48**
Free cash flow per share	**$7.62**
Dividends per share	**$3.47**

Source: Company reports, Quo Vadis Capital, Inc. estimates

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Summary on China

Chinese margins and ROIC are MUCH higher than the balance of the company

China is the largest driver of EBIT growth going forward

All else equal, a shift of 1% of sales contribution to China from North America should equity ~10 bps upward pressure on consolidated margins

China could conservatively grow to 26% of revs in FY28 from 11% in FY18 creating a 150 bps tailwind to EBIT margins

The shift of deployment of capital to Chinese stores represents an **improvement in return on incremental invested capital and should cause overall ROIC to rise**

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But Wait There's More:

This could be even more compelling than the China opportunity

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Step 3:

Sizing the capital return & leverage

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But Wait There's More ! Capital Return & Leverage

- **Starbucks recently announced it was increasing its leverage target one turn to 2.5x-2.9x EV/ EBITDAR**
- **And increased its total capital return target to $25B over FY18-FY20 (Sept. YE)**
- **The company also increased its dividend 20% to $1.44 (2.8% yield)**

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But Wait There's More ! Capital Return & Leverage

- **LET'S DO THE MATH**
- **Starbuck's current market cap is: $67B (was $80B+ not long ago)**
- **A capital return program of $25B = 37% of the equity value returned to shareholders over less than three years**
- **We currently estimate that SBUX could reduce the share count by the end of FY20 by more than 25% compared to the start of FY18**
- **Accretive to EPS**

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But Wait There's More ! Capital Return & Leverage

- **LET'S DO THE MATH***
- **Looking further out, we estimate that total capital return (dividends and share repurchase) could exceed the current market cap in less than 10 years**
- **Further, we estimate that share repurchase could reduce shares out by 44% by the end of FY28 vs. the current year**
- **This share repurchase will add an estimated 4-5 percentage points to EPS growth annually**
- **Share repurchase will account for an estimated 41% of average annual EPS growth over FY19-FY28**

* See end of this presentation for some of the assumptions in these forecasts or contact us for the model

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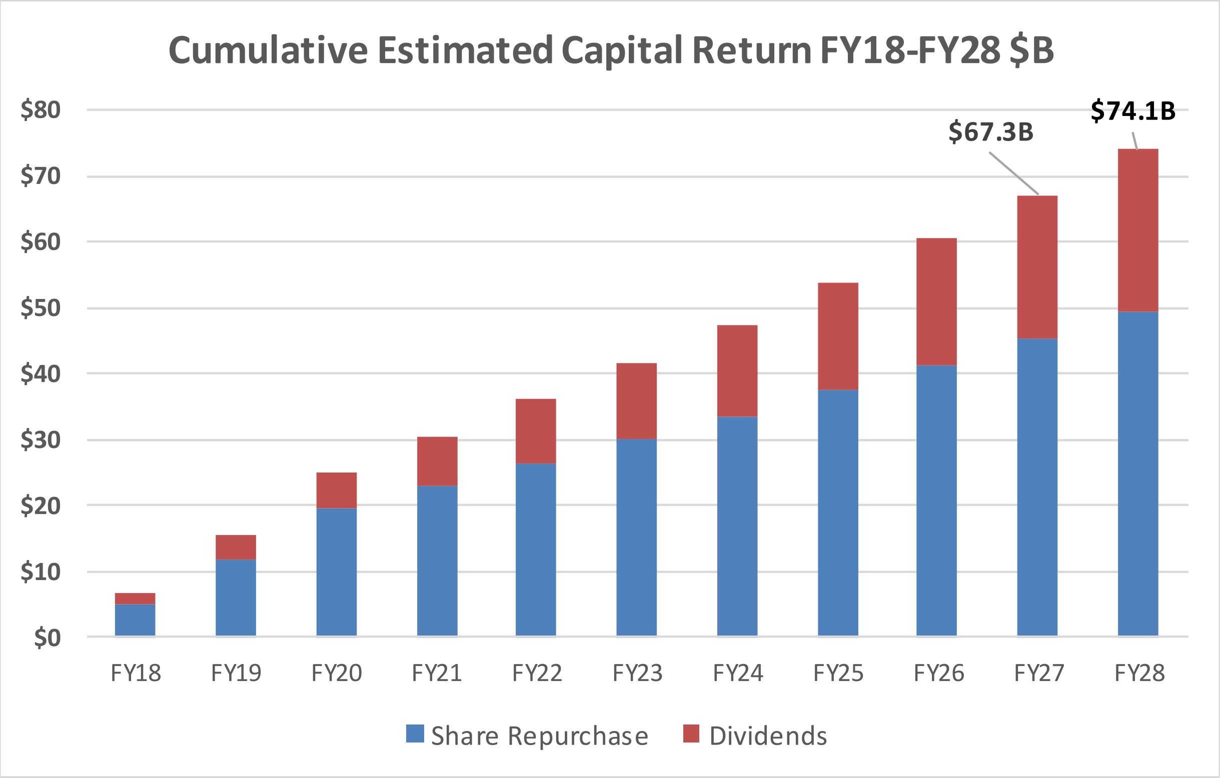
But Wait There's More ! Capital & Leverage

SBUX current market cap at $48/share = $67B; Cumulative capital return could exceed this by the end of FY27 (less than ten years from now)



Source: Company reports, Quo Vadis Capital, Inc. estimates

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Step 4:

Review of Valuation

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Review of Current Valuation

- **SBUX shares are currently trading 26% below an all time high (1 year ago)**
- **EV/ EBITDA has contracted to 12x NTM EBITDA from 18x two years ago**
- **Shares are currently trading at a P/E of 18x FY19 (Sept-19) EPS compared to a five-year range of 19x-33x and an average of 26x**
- **On EV/ EBITDA compared to FY19 forecasts, the stock trades for 11.7x compared to a five year range of 12.7x-18.4x and an average of 14.7x**
- **SBUX shares are currently trading below 5-year trough valuation ranges on FY19 estimates ***

* numbers probably need to come down

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Review of Current Valuation – vs. Peer Group

SBUX shares are currently trading at P/Es below a restaurant industry peer group and similar on an EV/ EBITDA basis despite vastly superior financial metrics

Quo Vadis Capital, Inc. Restaurant Universe

Relative Growth, Profitability, Balance Sheet & Valuation Metrics (Consensus Forecasts)

6/28/2018	AVG.	BJRI	CAKE	CBRL	CHUY	CMG	DFRG	EAT	HABT	PLAY	RRGB	SBUX	SHAK	TACO	TXRH	ZOES
Recent Price		$61.85	$55.66	########	$30.35	$426.78	$13.05	$49.05	$9.90	$48.59	$47.23	$48.11	$67.02	$14.02	$66.47	$9.41
Mkt Cap ($B)		$1.3	$2.6	$3.8	$0.5	$11.9	$0.3	$2.3	$0.3	$2.0	$0.6	$67.7	$2.5	$0.5	$4.8	$0.2
ENT VALUE ($B)		$1.4	$2.7	$4.0	$0.5	$11.7	$0.3	$3.6	$0.3	$2.3	$0.8	$72.0	$2.4	$0.7	$4.6	$0.2
Profitability Metrics																
ROIC TTM	10.3%	12%	13%	24%	16%	14%	-6%	17%	-3%	16%	3%	19%	8%	9%	17%	-3%
EBITDA Margin TTM	13.4%	11%	11%	13%	12%	11%	11%	14%	8%	25%	10%	22%	19%	14%	15%	7%
Valuation Metrics																
Vs. 2017A EPS (P/E)	36.7x	43.9	21.4	18.9	31.6	64.7	17.4	15.3	61.9	18.7	19.0	23.4	117.6	27.0	33.7	NM
Vs. 2018E EPS (P/E)	31.6x	30.8	20.8	16.9	27.2	49.2	21.5	13.9	NM	17.8	18.6	19.9	123.5	23.3	27.7	NM
Vs. 2019E EPS (P/E)	26.0x	28.3	19.1	16.4	24.8	36.2	14.0	13.1	NM	15.9	15.7	17.9	91.2	21.2	24.4	NM
EV / 2018 Sales	1.6x	1.3	1.1	1.3	1.3	2.4	0.7	1.1	0.7	1.9	0.6	2.8	5.4	1.4	1.9	0.7
EV / 2017 EBITDA	13.5x	13.0	10.6	10.2	12.3	25.1	6.2	8.5	9.2	8.7	6.0	13.3	43.1	10.0	15.7	10.4
EV / 2018E EBITDA	13.1x	11.6	11.1	10.2	11.9	21.3	6.7	8.8	9.3	8.5	6.0	12.7	41.8	9.8	14.9	12.8
EV / 2019E EBITDA	11.4x	11.0	10.6	9.8	10.9	18.1	4.9	8.9	8.4	7.7	5.7	11.7	29.7	9.4	13.3	10.7
Free Cash Flow Yield ('18)	2.2%	4.7%	3.0%	1.0%	N/A	2.7%	N/A	8.8%	-7.3%	2.9%	9.9%	4.2%	0.0%	2.2%	2.1%	-5.3%
Dividend Yield	1.0%	0.3%	2.1%	5.2%	0.0%	0.0%	0.0%	3.6%	0.0%	0.0%	0.0%	2.8%	0.0%	0.0%	1.6%	0.0%

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Investment Recap:

SBUX shares are trading at levels not seen in years due to near-term noise and complexity

Meanwhile we estimate **China will produce the majority of EBIT growth going forward** which should generate upward pressure on margins and ROIC

Further, planned **capital return represents ~37% of the market cap by the end of FY20 and could exceed the entire equity value** in less than 10 years, creating a significant tailwind for EPS, returns and the share price

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Risks & Other Considerations

Reminder: In this presentation, we have not even addressed several near-term issues that have impacted both results and the stock price performance

Our analysis of the China opportunity, leverage, and future EBIT margins involved many assumptions

Forecasting five and ten years into the future is inherently difficult

Our long-term forecasts have not been blessed by the company

SBUX results in the past have been impacted by changes in commodity prices and have shown some economic cyclicality

Near-term estimates from the Street likely have to come down

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Some of the Assumptions in Our Work

Company-operated North American store business is mature (2% comps, minimal unit growth) stable margins

China unit growth increases slightly, margins rise slightly, comps grow MSD over time

Rest of Company (ROC) grows HSD slowing to MSD with stable margins

Company continues to repurchase shares, grow dividend 10% annually, maintain leverage ratio 2.5-2.9x lease-adj. debt to EBITDAR

Interest rates rise slightly over time and share price (for repurchase) rises ~10% annually

Blended tax rate does not change

We believe these assumptions are conservative and below the company's internal forecasts

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