



QUO VADIS
CAPITAL

Proprietary Structural Analysis & Forecasting



Starbucks (SBUX): Secret Menu



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About Quo Vadis Capital & Speaker Bio

About Quo Vadis Capital:

- Registered Investment Advisor providing equity research on the U.S. consumer sector for institutional investors
- Also manage separate equity portfolios for individuals
- Approach is based on ROIC and return on incremental invested capital

Brief Resume John Zolidis:

- Equity analyst since 1999
- Founded Quo Vadis in 2017



Presentation Agenda

- **Why are we talking about Starbucks?**
- **Investment thesis**
- **Sizing the China growth potential**
- **Capital allocation and capital return**
- **Valuation**
- **Conclusion**
- **Risks**
- **Disclosures**

Why are we talking about Starbucks (SBUX)?

Up ~21,000% since 1992 IPO. But has underperformed over last two years and tanked in the last week (see two year chart):



First Question You Should Ask:

But why do we have a chance to buy such a great company at a much lower price?



Short Answer:

Because it's a massive headache

Slightly more informative answer:

The following issues 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)



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 (5 & 10 year) impact of:

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

Investment case to prove:

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

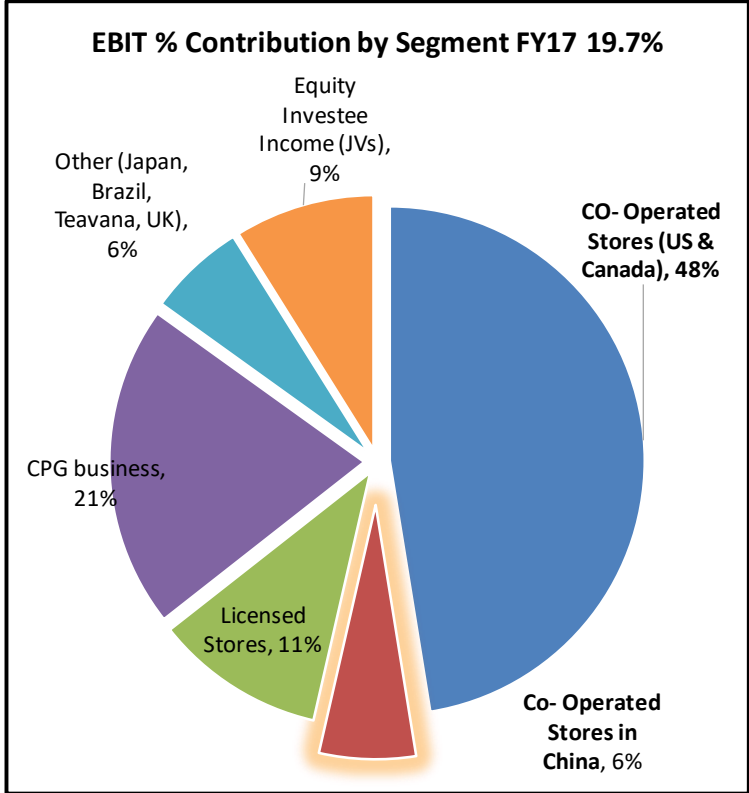
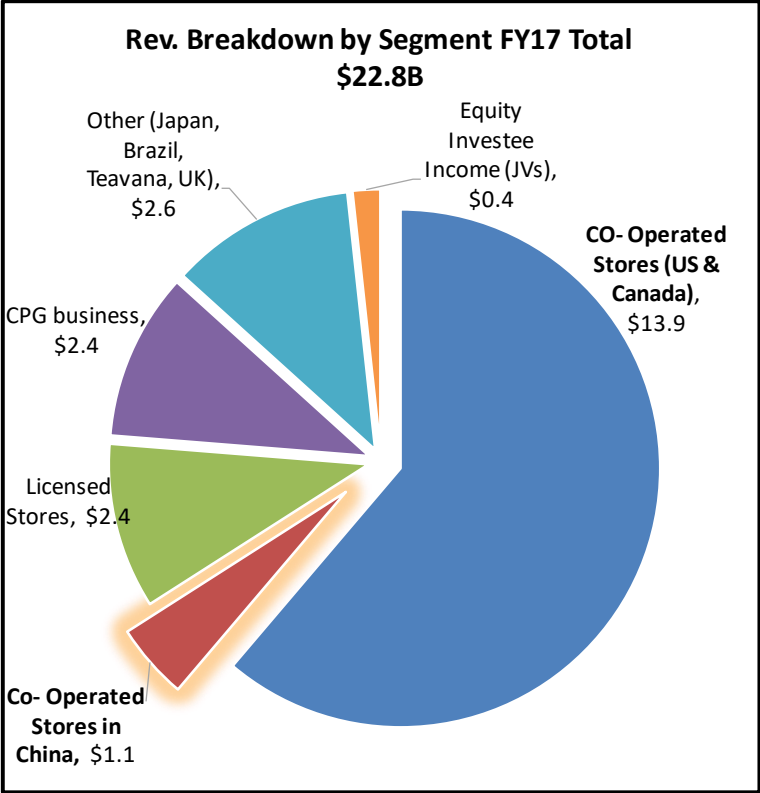


Step 1:

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



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

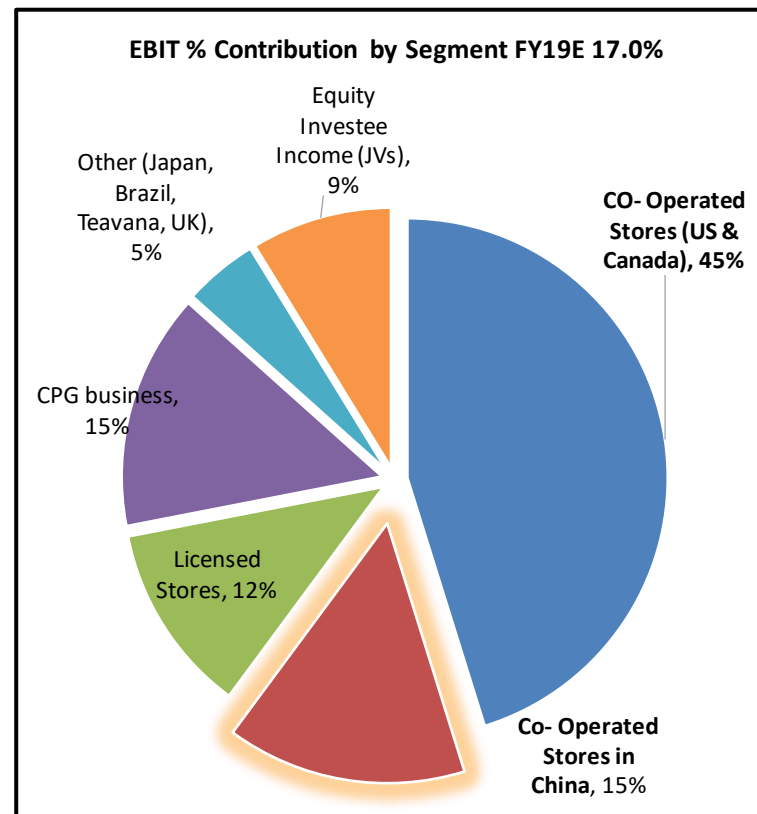
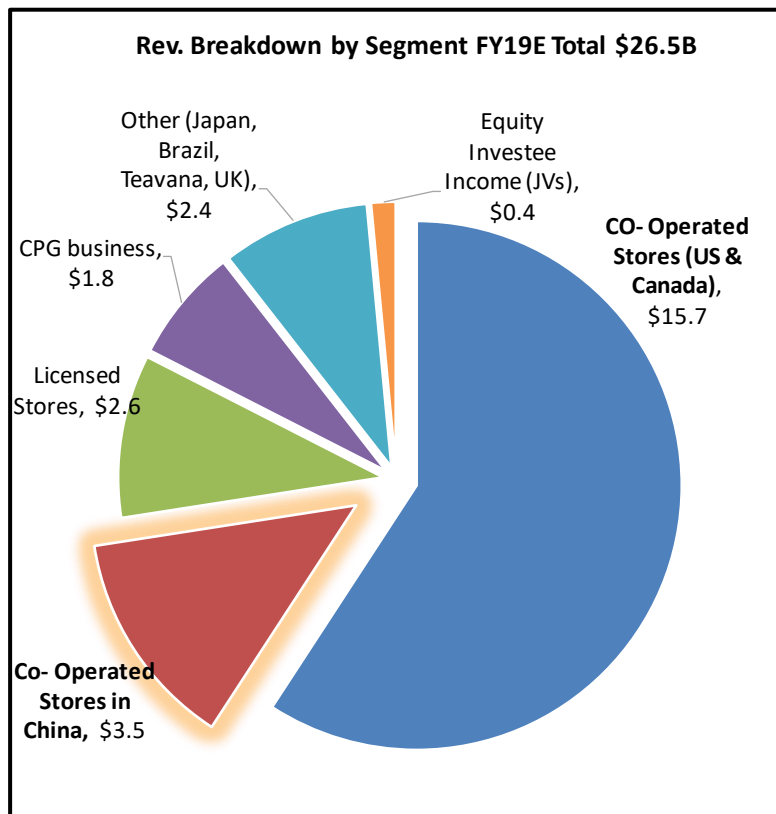
Source: Company reports, Quo Vadis Capital, Inc. estimates

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 about 100 previously company-operated stores in Brazil**
- **Sells its branded consumer products business to Nestle for \$7B (deal to close near start of FY19)**
- **Does other things that I forgot**

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

But then 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?

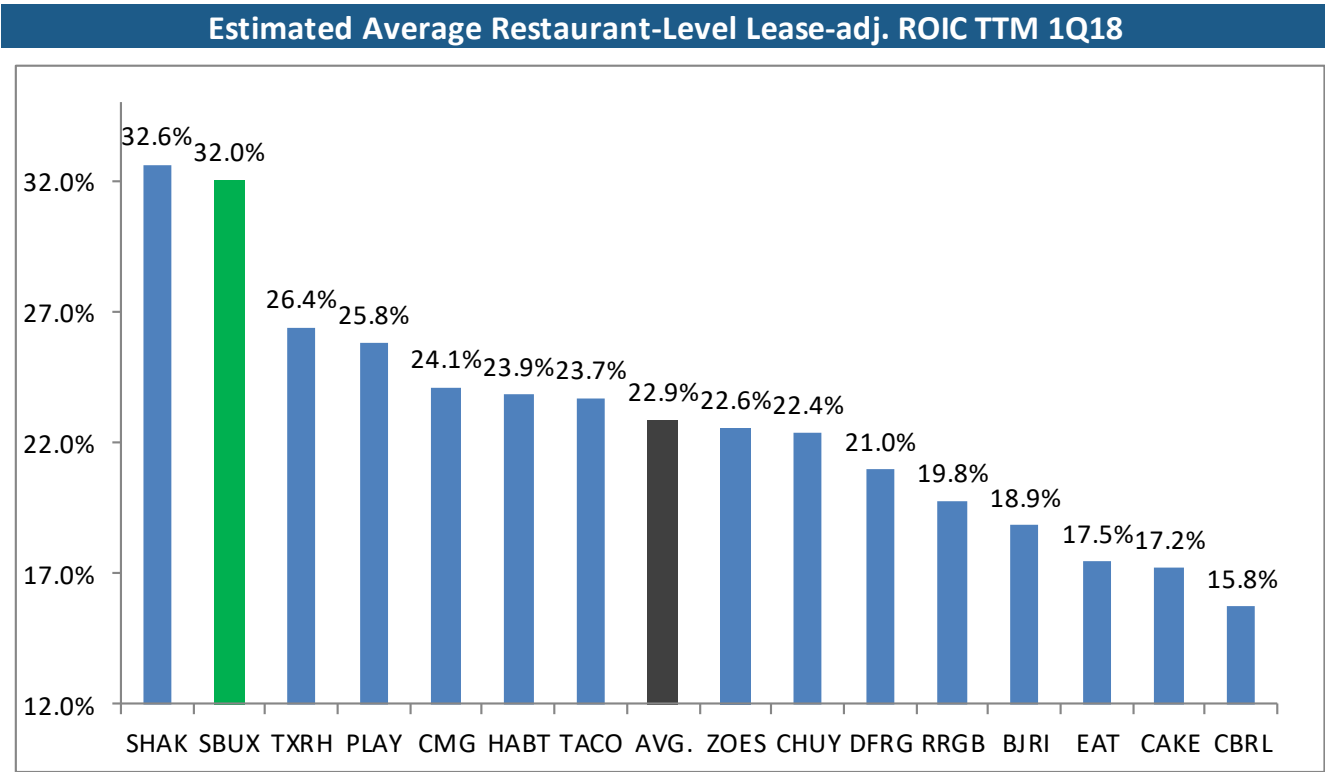


Step 2:

Establish why China matters

First Some Context:

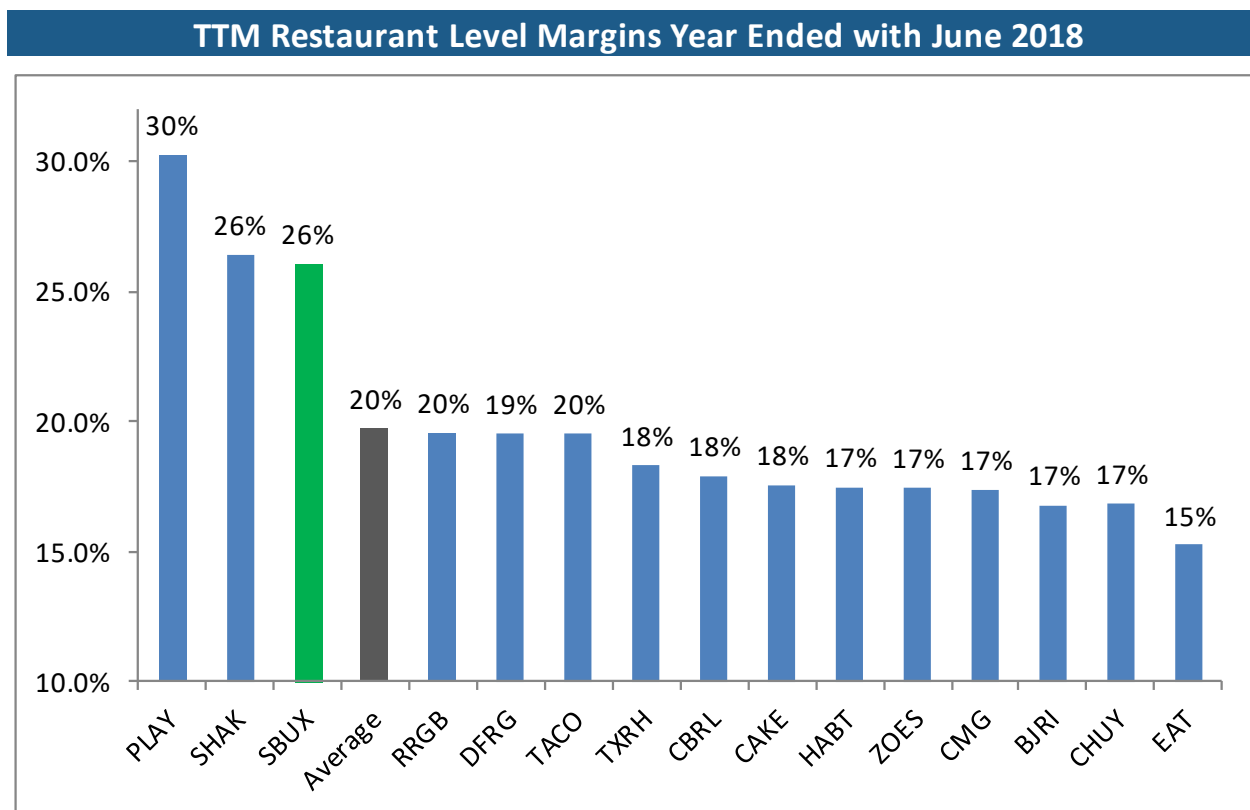
➤ SBUX ROIC at the store level is among the best in the industry:



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

First Some Context:

- High financial returns are due to lower capital requirements vs. other restaurants (no kitchen) and **high margins** of beverages (coffee)

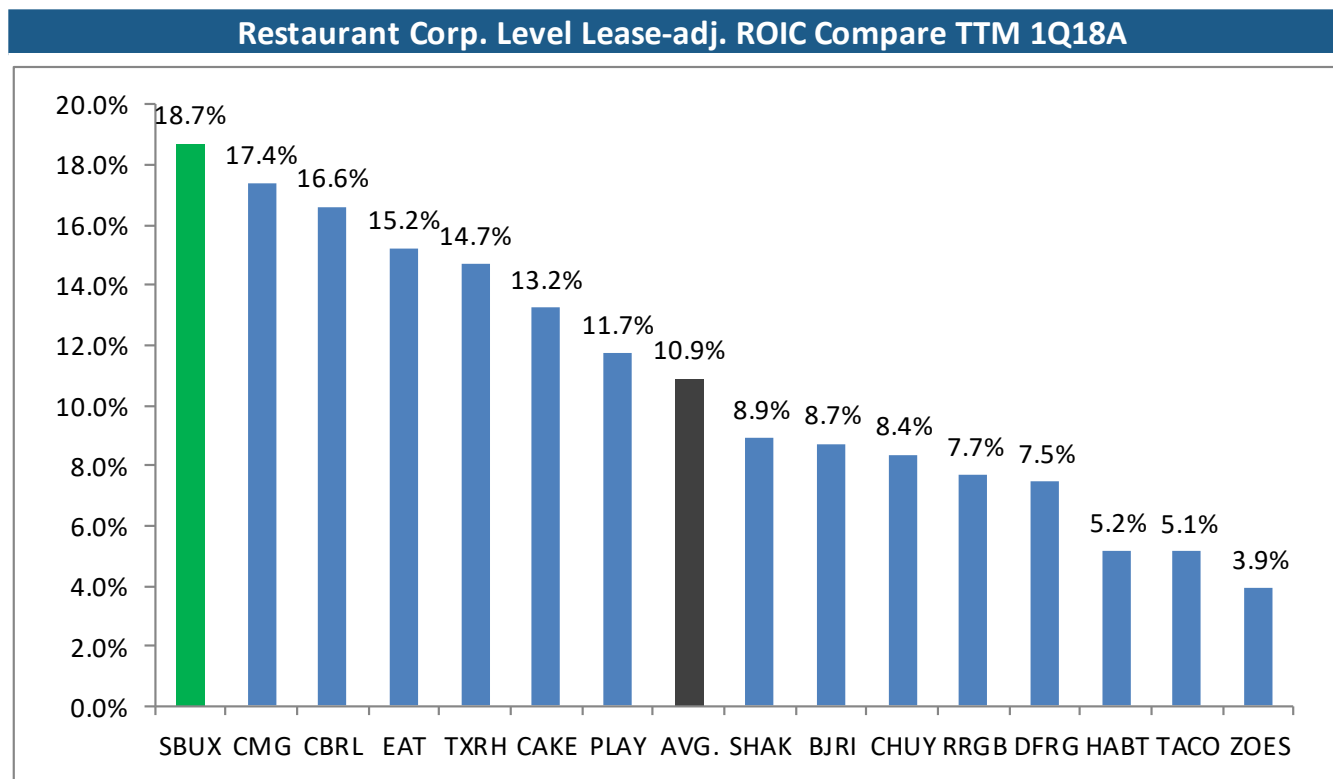


Source: Company Reports & Quo Vadis Capital, Inc. estimates



First Some Context:

- Starbucks as a company generates best-in-class ROIC due to its high store level returns, scale, licensed and other revenue streams, capital allocation



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



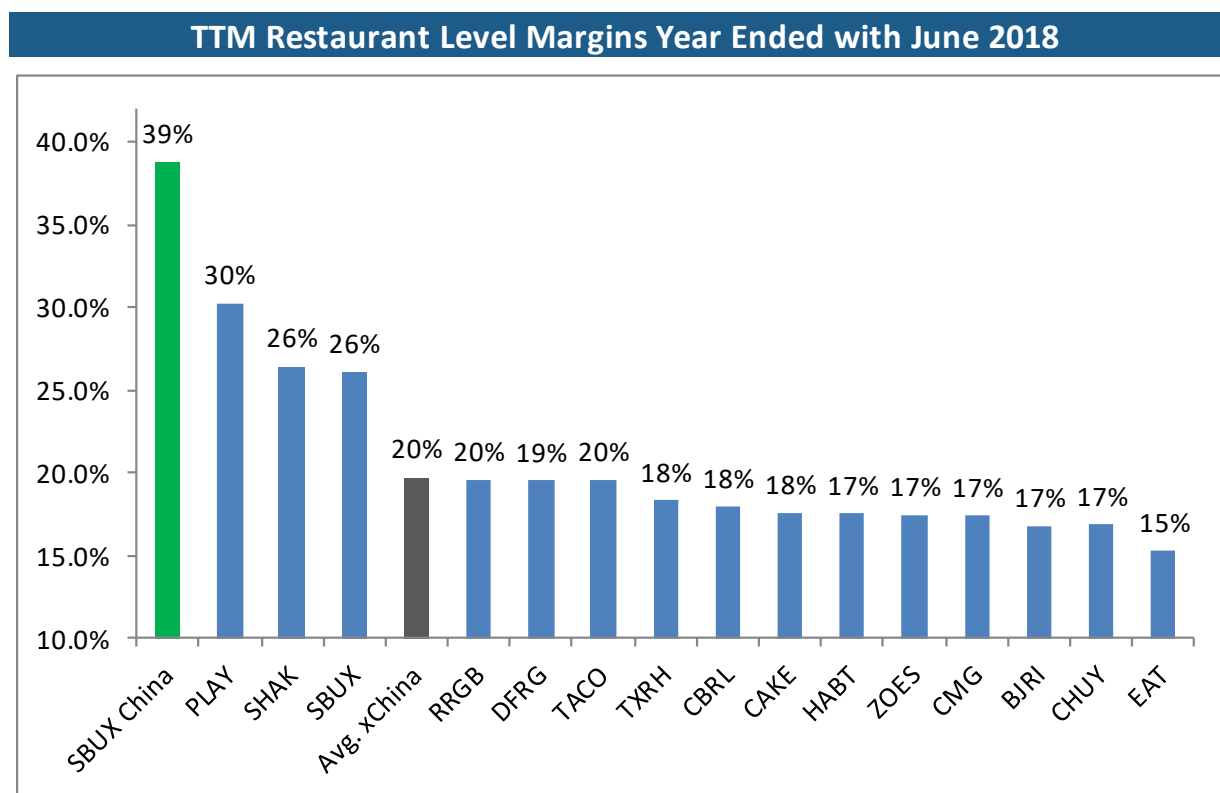
But everyone knows that and we didn't hear why we should care about China:

Hold your horses!



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

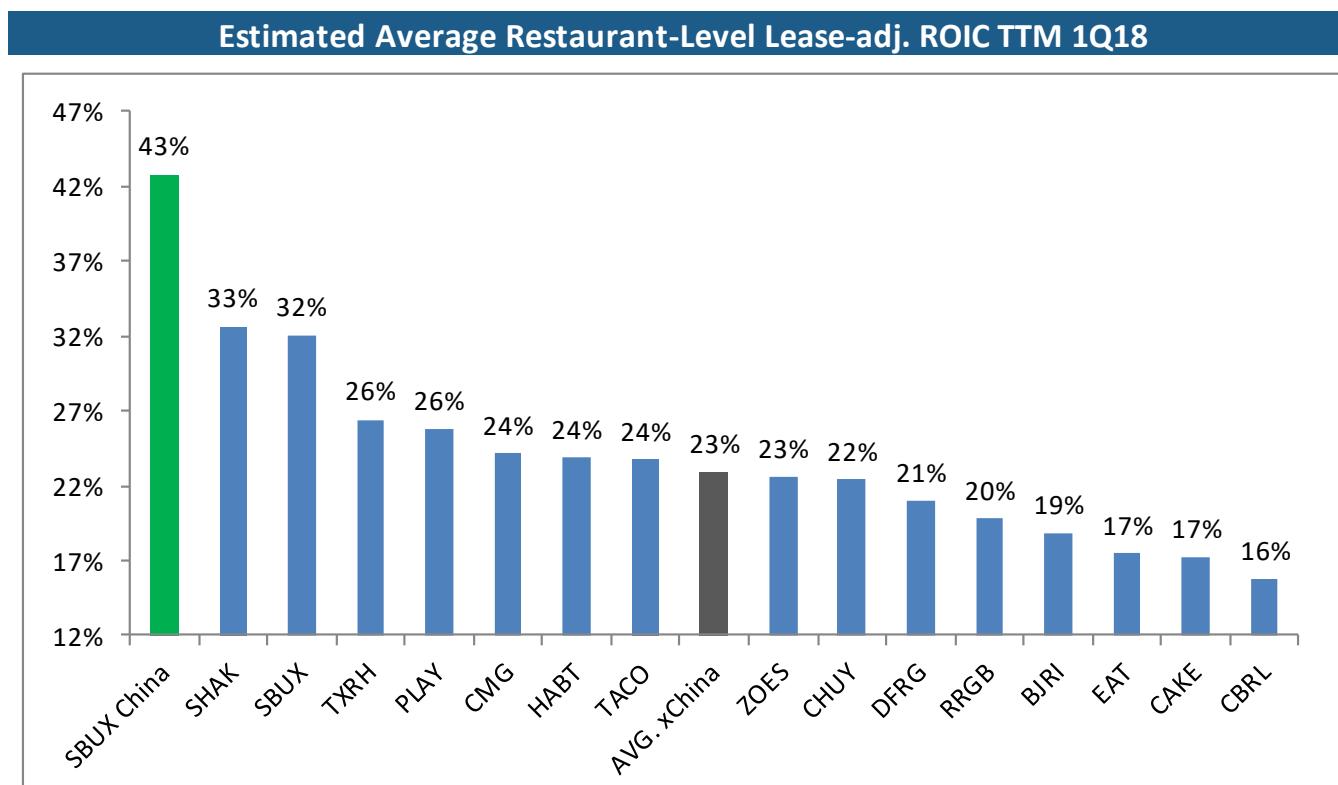


Source: Company Reports & Quo Vadis Capital, Inc. estimates



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:



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



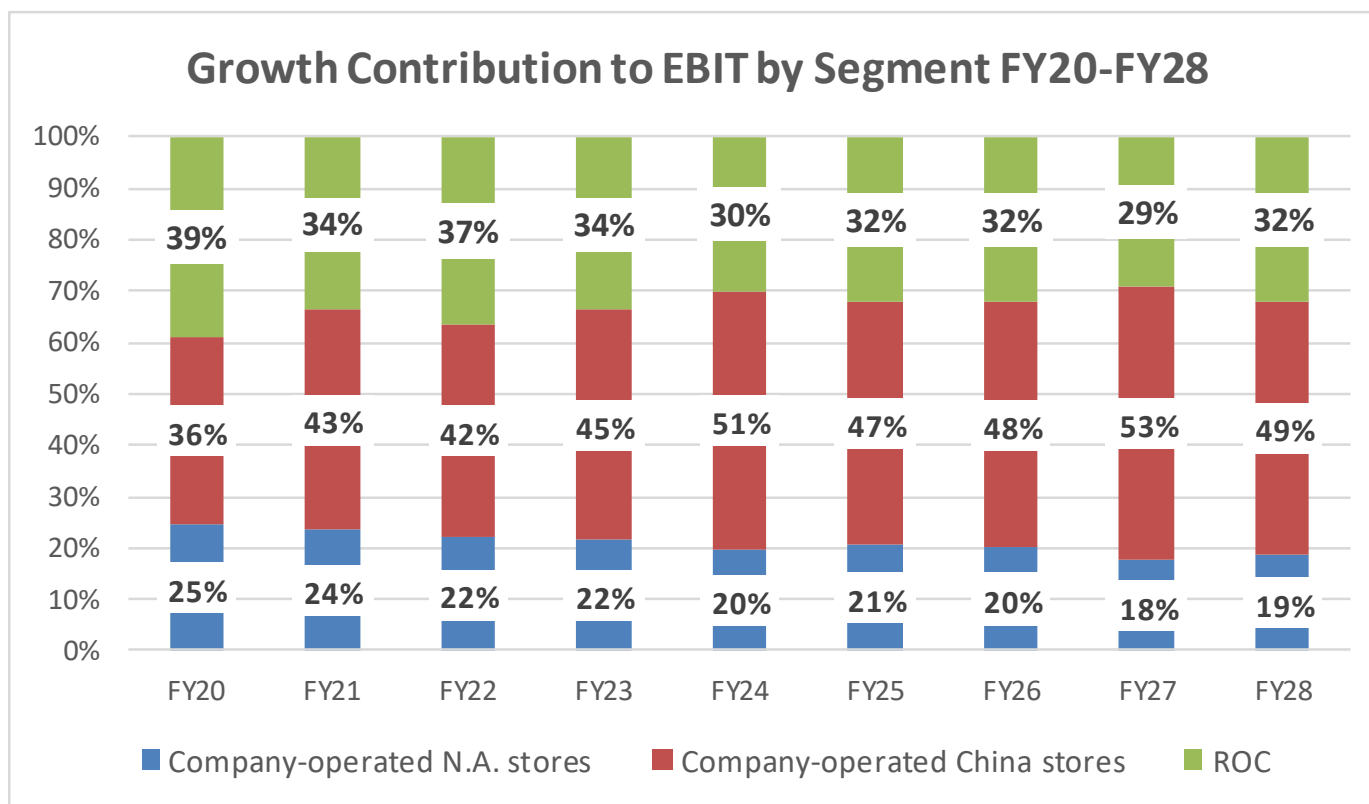
Shift of deployment of capital to Chinese stores from ROC should result in a higher return on **incremental** invested capital

All else equal, a shift of 1% of sales contribution to China from the U.S. should equal ~10 bps upward pressure on consolidated margins

We estimate China could grow to 26% of revenues in FY28 from 11% in FY18 creating a 150 bps tailwind to EBIT margins

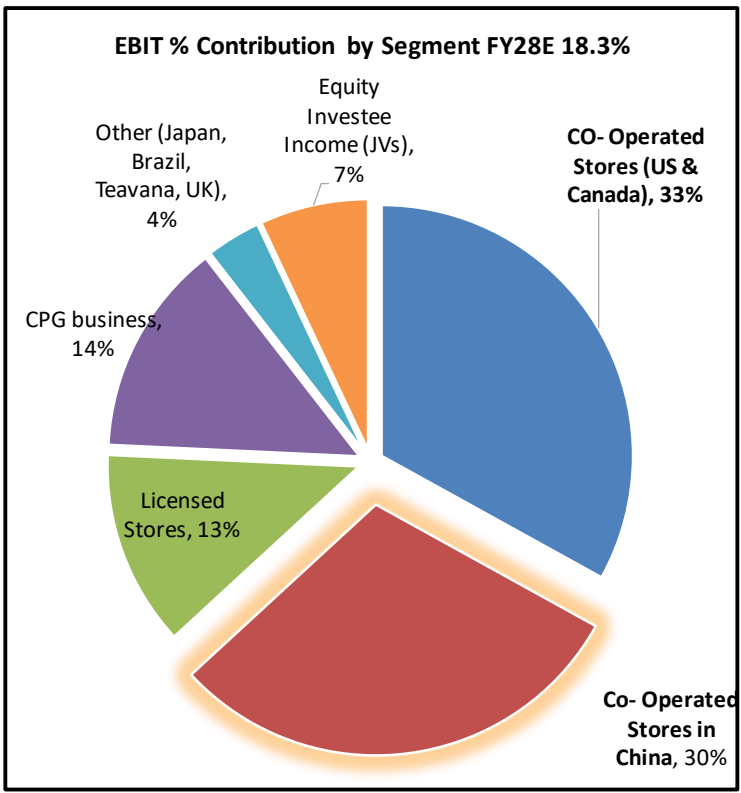
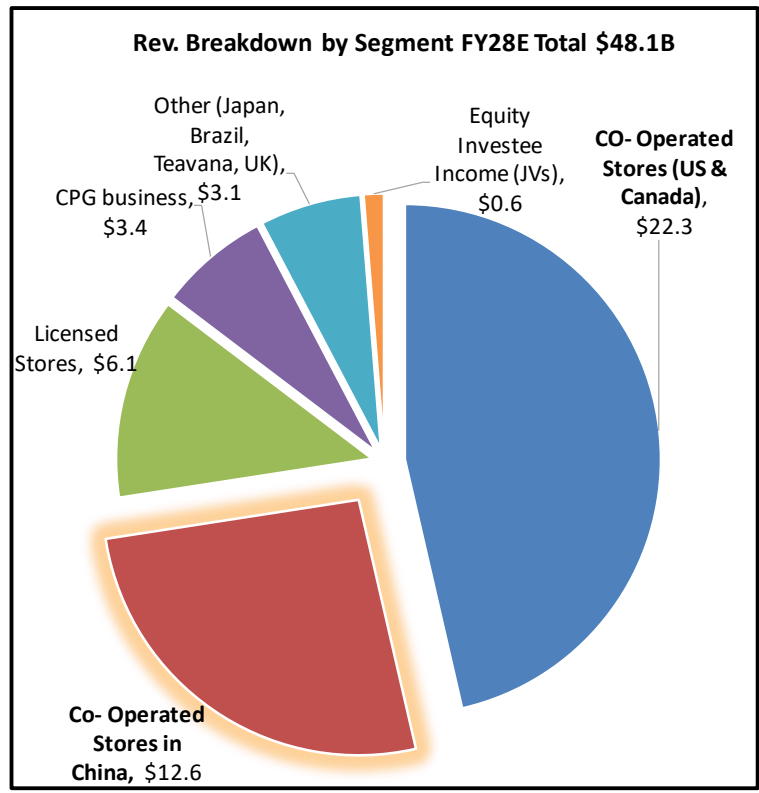
Further, despite its size today, we estimate China is the largest driver of EBIT Growth Going forward

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

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

But Wait There's More:

This could be even more compelling than the China opportunity



Step 3:

Sizing the capital return & leverage



But Wait There's More ! Capital Return & Leverage

- SBUX has historically generated significant FCF, paid a dividend and bought back stock
- The company recently increased its dividend 20% to \$1.44 (2.8% yield)
- And increased its total capital return target to \$25B over FY18-FY20 (Sept. YE)
- The company also announced it was **increasing its leverage target** one turn to 2.5x-2.9x

But Wait There's More ! Capital Return & Leverage

➤ LET'S DO THE MATH

- Starbucks's current market cap is: \$67B (was \$80B+ not long ago)
- **A capital return program of \$25B = 37% of the market 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

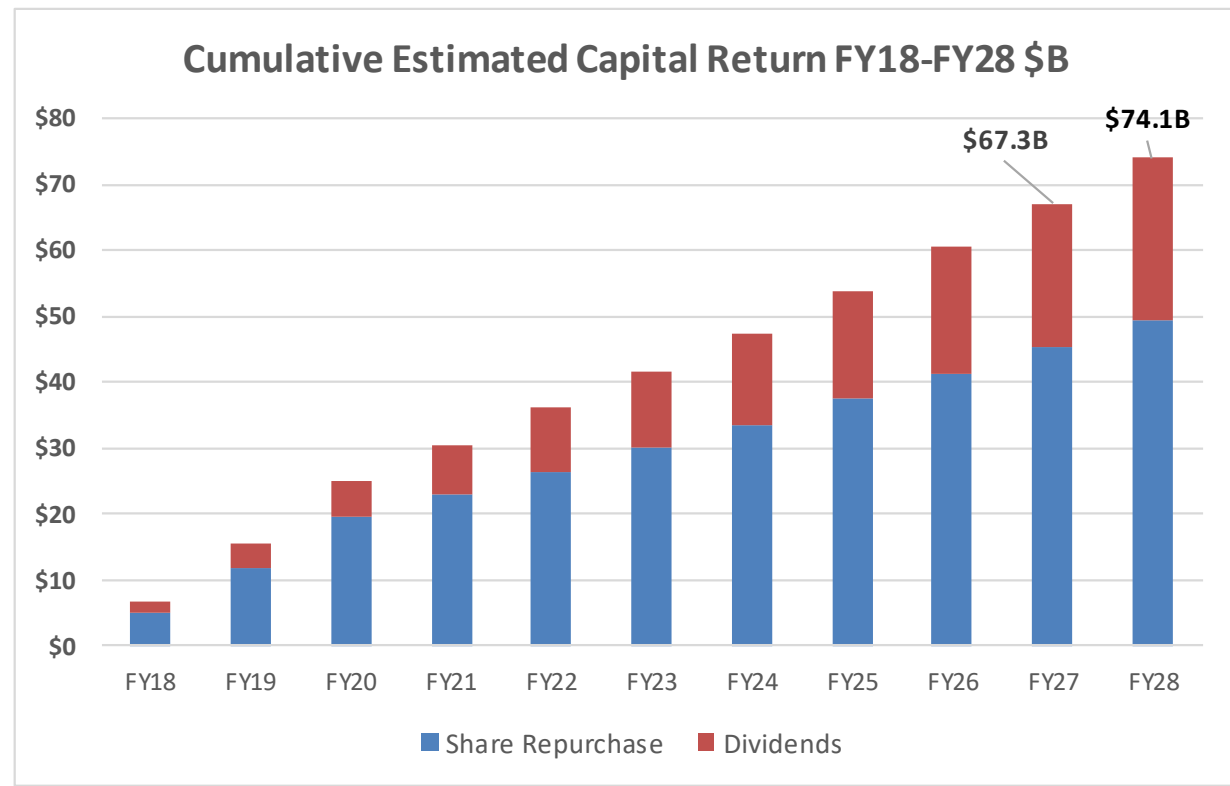
But Wait There's More ! Capital Return & Leverage

➤ 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

But Wait There's More ! Capital & Leverage

SBUX current market cap = \$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

Step 4:

Review of Valuation

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 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

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	12.3	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%



Investment Conclusion:

We are at a point of maximum near-term noise causing SBUX shares to trade at levels not seen in years

Meanwhile the **LT cash flow and growth from China is compelling** even as the North American business matures

Further, **capital return** partially funded by increased leverage **could equal the current market cap** over less than 10 years

Risks & Other Considerations

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

Our analysis of the China opportunity, leverage, and future EBIT margins involved a myriad of 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 cyclical

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



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