Equity Qualitative Research Report

NASDAQ: SBUX

Prepared By: Zack Schaja (VP), Jack McGuire (Analyst), Carter Hardy (Analyst)

September 29th, 2017

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Business Description

Starbucks Corporation operates as an international retailer, marketer and roaster of specialty coffees and beverages. Its stores offer a variety of products including made-to-order coffee and tea beverages, packaged whole-bean and ground coffees, single-serve and ready-to-drink coffee and tea products, juices, and bottled water. Starbucks has also been growing its selection of food products including pastries, breakfast sandwiches, and lunch items.

Starbucks also licenses its trademarks and offers products in supermarkets and convenience stores under the Starbucks, Teavana, Tazo, Seattle's Best Coffee, Evolution Fresh, La Boulange, Ethos, Frappuccino, Starbucks Doubleshot, Starbucks Refreshers, and Starbucks VIA brands. The company, which was founded in 1971 in Seattle, WA, operated or licensed 23,768 stores as of November 2016.

Opportunity Analysis

International Growth – Starbucks paid $1.3B to a partner in July to obtain sole ownership of 1,300 Starbucks locations in China, adding to the company's previous 1,500 stores in the country. Starbucks has a long-term goal of placing 5,000 locations in China by 2021. China same-store sales increased by 7% in Q3, fueled by a growing middle class.

Customer Loyalty – Starbucks has always been on the cutting edge when it comes to customer loyalty programs. In 2015, Starbucks was the most popular rewards program and mobile payment app in the US, a signal of their commitment to being a technological pioneer. The company recently revamped their loyalty program in order to favor customers who make more expensive purchases. Mobile order-and-pay transactions increased to 9% of all transactions in the US and comparable store sales increased by 4%.

Channel Development Segment – Channel development revenue grew by 8.6% in Q3, mainly due to K-Cup, roast/ground coffee, and ready-to-drink tea sales. K-Cup sales grew by 10% during the quarter and Starbucks now controls 16.6% of the K-Cup market. Roast and ground coffee sales rose 8% over the quarter, with Starbucks currently controlling 13% of the sub-sector's market share.

Risk Analysis

Economic Decline – During tough economic times, Starbucks' average purchase drops as people move away from specialty beverages. The company saw a 70% decline in EPS during the financial crisis, although overall coffee consumption did not change. With their average purchase amount at an all-time high, another economic slump could cause a similar decline in earnings.

Variable Coffee Prices – Coffee has historically been one of the most volatile commodities, with prices depending heavily on weather in Southeast Asia and Central America. Starbucks' coffee purchases represent ~35% of COGS, and prices have fluctuated by ~50% in the past five years. However, Starbucks uses fixed-price and price-to-be-fixed contracts for coffee purchases, as well as financial derivatives to manage its commodity price risk exposure.

Oversaturation – There are now an average of 3.6 Starbucks locations within a one-mile radius of the typical Starbucks in the US. This number is up from 3.3 and 3.2 stores in 2014 and 2012 respectively. The mass-placement of near-proximity stores could hurt the company if economic growth slows unexpectedly.

Local Coffee Shop Trend – Although there are not many national coffee brands besides Starbucks and Dunkin' Donuts, local and regional coffee shops do own 38% of the market share. Independent coffee shops offer high quality coffee in an attempt to steal the coffee connoisseur market from Starbucks. As Starbucks grows, it may be more difficult for it to maintain its image as a premium brand.

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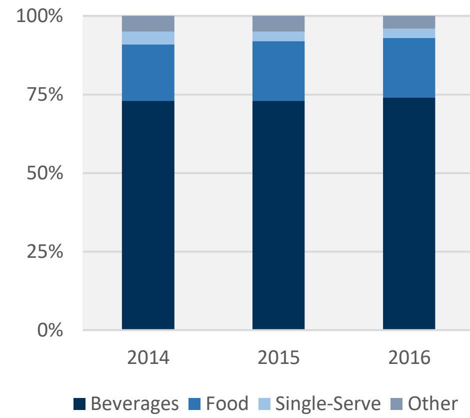
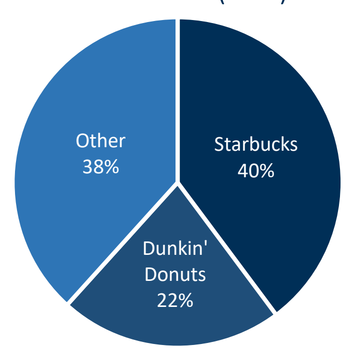
Ticker: SBUX
Current Price: $53.71
P/E Ratio: 27.22
Div Yield: 1.87%
52-Week Range: $50.84 - $64.84
Beta: 0.77
Market Cap: $78.6B

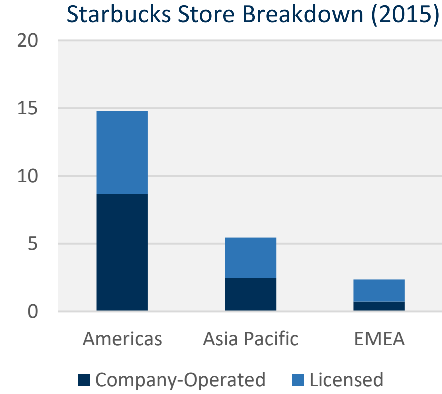
Retail Sales Mix by Product Type for Company-Operated Stores



Market Share of the Leading Coffee Chains in the US (2016)



Starbucks Store Breakdown (2015)



Equity Quantitative Research Report

NASDAQ: SBUX

Prepared By: Jamie Leyden (VP), Pam Niditch (Analyst), Zack Spickard (Analyst)

September 29th, 2017

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Our Methodology

Starbucks is a fast growing coffee company with close to 25,000 stores worldwide. They have been growing rapidly both domestically and in foreign markets such as China. The goal of this report is to model this growth and provide a fair valuation for the company. We will use this valuation to determine whether we believe Starbucks is undervalued, as it has declined 15% from its high in May.

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Best/Base/Worst Case Analysis

Best Case

The best case scenario for Starbucks' stock includes continued double digit revenue growth, continuing and adopting a social and high-end in-store experience, expansion opportunities in China, and a revitalized food/beverage menu that elevates the Starbucks customer experience. Additionally, we factored in Starbucks' channel development revenue due to the company's large increase in K-cup sales.

Under this scenario, we see Starbucks' share price rising to **$72.02**, representing a **34.1%** share premium as of 9/29.

Base Case

The base case for Starbucks includes steady 7-9% revenue growth from their core segments as a coffee retailer and consumer packaged goods platform. These projections take into account a more modest estimate of expansion in China, a steady revenue growth in the U.S., and a consistent level of customer loyalty.

Under this scenario, we set Starbuck's target price at **$62.08**, representing an **15.6%** share premium as of 9/29.

Worst Case

The worst case scenario for Starbucks' shares assumes that Starbucks will not meet its projections for growth in China. We factored in the possibility that a domestic competitor enters the Chinese market, taking market share away from Starbucks. Additionally, we recognized the small coffee shop competitors and the local coffee shop trend in the United States. We factored in the possibility that these businesses take away some of Starbucks' customers.

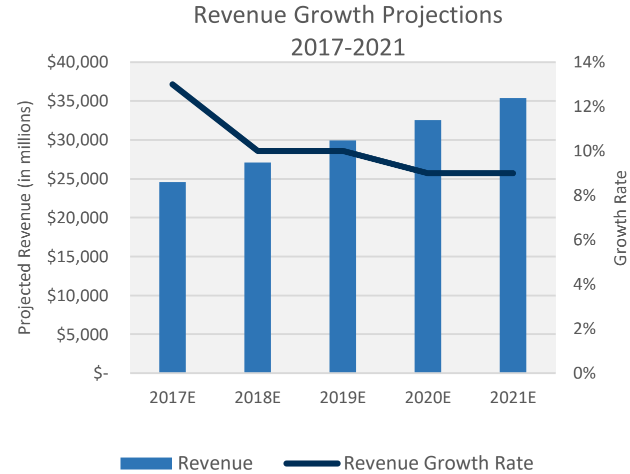
Under this scenario, we have set the floor of Starbucks' share price at **$49.00**, which would represent a correction of **(8.8%)** as of 9/29.

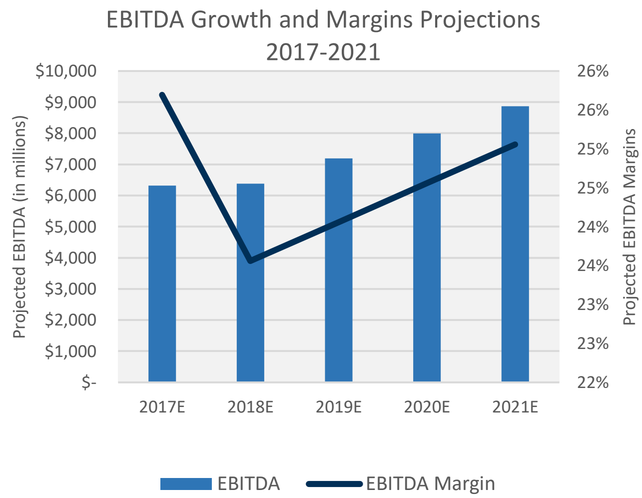
Comparable Company Analysis

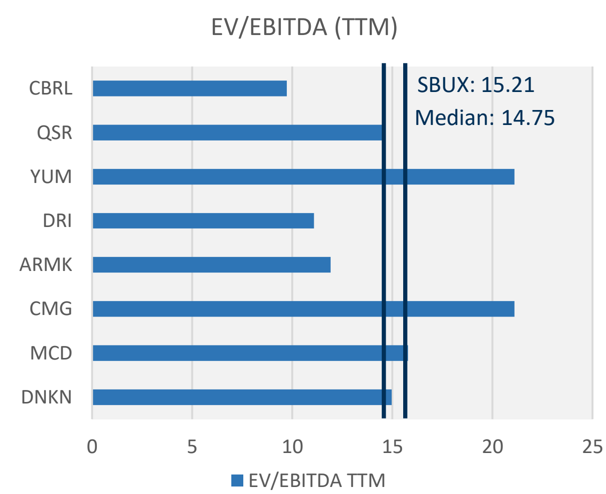
Finding comparable companies for Starbucks was difficult, considering that 62% of the market is controlled by Starbucks and Dunkin' Donuts. The rest is controlled mostly by McDonald's and smaller independent coffee brewers. In place of more coffee companies, we found restaurant companies who could rival Starbucks in size and structure. Starbucks, however, has some considerations that these chains do not, such as their variety of brands and volatility due to commodity prices.

Starbucks has an EV/EBITDA multiple that is slightly above the average for the comparable companies. A premium justified because it boasts a 40% market share of coffee chains in the US. Starbucks is the best-positioned company to expand the coffeehouse concept to locations around the world, due to its investments in emerging markets and a consolidated coffee market.

Operating Projections







Final Investment Thoughts

NASDAQ: SBUX
Prepared By: Sam Jones (President), Casey Lambert (CIO)
September 29th, 2017

Investment Decision

GIMG has made the decision to take a position in Starbucks (NASDAQ: SBUX). We believe that Starbucks has the potential to continue expansion into international markets, specifically China. The plan for Starbucks to nearly double its stores in China by 2021 and continue to generate strong same-store sales growth makes it an attractive investment opportunity.

The expansion plans and stable same-store sales growth of Starbucks make it an attractive investment to add to the core GIMG portfolio, which is comprised of stocks that we plan to hold for 3-5 years. In addition to the capital appreciation we expect from Starbucks, the 1.9% dividend yield is an attractive characteristic for our core portfolio. While slightly below the S&P 500 yield, we believe that the dividend will continue to grow after nearly doubling since 2014.

We remain concerned about the growing trend of local coffee shops taking away market share and gaining in popularity. However, we remain confident that Starbucks will be able to maintain its hold on the coffee industry as it has created a culture and community around its stores. Starbucks is a place that people go to get coffee, write papers, study for tests, and socialize with colleagues. We believe that continued same-store sales growth is reasonable and that the growing number of independent coffee shops is not as large a threat as some investors may believe.

After careful research and discussion, we have decided to enter a position in Starbucks that will comprise approximately 8% of our overall portfolio and about 16% of the core portfolio.

With the below signatures, we approve the decision to purchase Starbucks (NASDAQ: SBUX) for the GIMG Equity Fund portfolio.

Casey Lambert, Chief Investment Officer: Casey Lambert

Sam Jones, GIMG President: Sam Jones

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