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Equity Valuation: Starbucks Corporation

Rita Maia Matias

Master in Finance

Supervisor:
PhD Luís Miguel da Silva Laureano, Assistant Professor,
Iscte Business School

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BUSINESS
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Department of Finance

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Abstract

This project was undertaken to appraise the share value of Starbucks Corporation by the end of 2023, aiming to determine whether the shares were traded at their fair value in the market.

Founded in 1971, Starbucks Corporation is a prominent American coffee company and coffeehouse chain with its headquarters situated in Seattle, Washington. In addition to its signature coffee offerings, Starbucks Corporation provides a diverse range of products, including tea, pie, cake, and other commodities.

The Equity Valuation conducted in this project relies on two methodologies: The Discounted Cash Flow method using the Free Cash Flow to the Firm and the Relative Valuation approach. To emphasize the risks associated with the valuation and the subjectivity inherent in the outcome, a sensitivity analysis is performed on certain factors derived from assumptions and forecasts. Moreover, data and information were retrieved from the company's Annual Reports and other sources to substantiate the analysis. Employing a blend of financial statements, market data, and valuation methodologies, the study reveals Starbucks' intrinsic value and whether the shares were undervalued or overvalued during the period under analysis.

Starbucks Corporation is publicly traded on the Nasdaq Global Select Market ("Nasdaq"). As of December 31, 2023, the company's share price stood at $96.01. Through the Discounted Cash Flow valuation, the calculated share value was determined to be $92.86. The results obtained from the Equity Valuation process suggest that the shares of Starbucks were overvalued at the period under analysis, despite being close to the reported intrinsic value.

Keywords: Starbucks Corporation; Equity Valuation; Consumer Discretionary Sector; Discounted Cash Flow Valuation; Relative Valuation

JEL Classification: G30; G32

Resumo

Este relatório avalia o valor das ações da Starbucks Corporation até ao final de 2023, com o objetivo de determinar se as mesmas foram transacionadas pelo seu justo valor no mercado.

Fundada em 1971, a Starbucks Corporation é uma importante empresa americana de café e uma cadeia de cafetarias com sede em Seattle, Washington. Para além do café, a Starbucks Corporation fornece uma gama diversificada de produtos, incluindo chá, tartes e bolos.

A avaliação da empresa foi baseada em duas metodologias: Fluxo de Caixa Descontado usando o Fluxo de Caixa Livre para a Empresa e a Avaliação Relativa. Para enfatizar os riscos associados à avaliação e a subjetividade inerente ao resultado, é realizada uma análise de sensibilidade a determinados fatores derivados de pressupostos e previsões. Além disso, foram recolhidos dados e informações dos relatórios anuais da empresa e de outras fontes para fundamentar a análise. Utilizando uma combinação de demonstrações financeiras, dados de mercado e metodologias de avaliação, o relatório revela o valor intrínseco da Starbucks e se as ações estavam subvalorizadas ou sobrevalorizadas durante o período em análise.

A Starbucks Corporation é negociada publicamente no Nasdaq Global Select Market. A 31 de dezembro de 2023, o preço das ações da empresa era de $96,01. Através da avaliação pelo Fluxo de Caixa Descontado, o valor das ações calculado foi de $92,86. Os resultados obtidos no processo de avaliação de ações sugerem que as ações da Starbucks estavam sobrevalorizadas no período analisado, apesar de estarem próximas ao valor justo reportado.

Palavras-Chave: Starbucks Corporation; Avaliação da empresa; Cafetaria; Avaliação por Fluxo de Caixa Descontado; Avaliação Relativa

Classificação JEL: G30; G32

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Glossary

$ – U.S. dollar

% - Percentage

β_D – Debt Beta

β_L – Beta Levered

β_U – Beta Unlevered

CAGR – Compound Annual Growth Rate

CAPEX – Capital Expenditures

CAPM – Capital Asset Pricing Model

CF – Cash Flow

CRP – Country Risk Premium

D – Market Value of Debt

$\frac{D}{E}$ – Debt-to-Equity Ratio

D&A – Depreciation and Amortization

DCF – Discounted Cash Flow

E – Market Value of Equity

EBIT – Earnings Before Interests and Taxes

EPS – Earnings Per Share

EQV – Equity Value

$E(R_m)$ = Expected Market Return

EV – Enterprise Value

EV/EBITDA – Enterprise Value to EBITDA

EV/EG – Enterprise Value to EBITDA growth

EV/FCF – Enterprise Value to Free Cash Flow

EV/Sales – Enterprise Value to Sales

FCFE – Free Cash Flow to Equity

FCFF – Free Cash Flow to the Firm

g – Growth Rate in perpetuity

GDP – Gross Domestic Product

IMF – International Monetary Fund

MRP – Market Risk Premium

P/BV – Price to Book Value

P/EG – P/E to EPS growth

P/E – Price to Earnings Ratio

pp – Percentage Point

P/S – Price to Sales

r_d – Cost of Debt

r_e – Cost of Equity

ROA – Return On Assets

ROE – Return On Equity

ROIC – Return On Invested Capital

r_f – Risk- free Rate

WACC – Weighted Average Cost of Capital

WC – Working Capital

t – Corporate tax rate

TV – Terminal Value

YTM – yield to maturity

Introduction

In a market economy, value is the most important dimension of measurement. Investors participate with the expectation that, at the time of sale, each investment's value will have grown sufficiently above its cost to compensate them for the risk they took. In fact, the primary metrics used to evaluate a company in a market economy are its ability to create value for its shareholders and the volume of value it creates. Hence, the process of valuing the company and the market it operates in is one of the most crucial tools available to managers and investors for locating the sources of economic value creation and destruction within a company.

Starbucks Corporation is a global coffee company and coffeehouse chain that started its business in 1971 on the streets of Seattle, Washington. Upon the opening of its inaugural store, the company originally started by selling whole-bean coffee, tea, and spices to customers. Nowadays the company is recognized as the largest chain of coffeehouses globally and operates in more than 32,000 locations across 80 markets worldwide, offering a diverse range of high-quality products and services. This includes handcrafted beverages, fresh-brewed coffee, hot and cold espresso drinks, non-coffee blended beverages, tea, and an assortment of fresh food items across company-operated stores. The company extends its offerings under various brands, such as Teavana, Seattle's Best Coffee, Evolution Fresh, La Boulange, and Ethos, in addition to the Starbucks brand. Key to its success is not only the exceptional product quality but also the company's skill in cultivating close customer relationships, emphasizing sustained proximity beyond product excellence. In alignment with this principle, the company's mission is encapsulated in the aspiration "to inspire and nurture the human spirit – one person, one cup, and one neighborhood at a time". On June 26, 1992, Starbucks went public at a price of $17 per share. On the first day of trading, the share price ended at $21.50. The common stock of Starbucks Corporation is traded on the NASDAQ market under the ticker symbol SBUX.

The primary aim of this report is to assess whether the shares of Starbucks Corporation were traded at their fair value in the market by comparing the intrinsic value with the actual closing share value at the end of 2023. To achieve this, the estimated value from financial models was compared to the actual market price. The valuation employed two methods: a DCF-FCFF approach to calculate Starbucks' equity value and a Relative Valuation approach for comparison with peers. The DCF-FCFF model estimated a share price of $92.86, closely aligned with the market price of $96.01, suggesting slight overvaluation. Both methods yielded similar outcomes, suggesting that Starbucks' shares were relatively well valued at the end of 2023.

Excluding the Introduction, this report will be organized into five sections. Chapter one encompasses a Literature Review, discussing the most pertinent valuation methods. Subsequently, chapter two conducts a more in-depth exploration of Starbucks Corporation and its operational

endeavors. The subsequent chapter, assumes significance as it delves into a macroeconomic overview covering global economies in recent years, alongside the distinctive features of the industry within which Starbucks Corporation operates. The fourth chapter provides a detailed valuation of the company, derived from the Discounted Cash Flow approach and the Relative Valuation. In the development of this section, a sensitivity analysis will be undertaken, underscoring the critical importance of assessing risk in decision-making. This step is indispensable as it enables the evaluation of how alterations in assumptions would impact the value, thereby offering insights into which assumptions exert a more substantial influence on the share price. To finalize this report, the main conclusions will be presented, culminating in whether the market shares were undervalued or overvalued compared to the intrinsic value.

1. Literature Review

The first chapter reviews existing literature on corporate valuation, focusing on Starbucks. It synthesizes key authors, studies and reports to understand financial metrics, operational strategies, and employee development practices. This review establishes the basis for evaluating Starbucks' market position and strategic effectiveness, highlighting relevant research and identifying gaps for further exploration.

1.1. Valuation Importance

According to Damodaran (2006, p. 3), “Valuation lies at the heart of much of what is done in finance”. Valuation holds a crucial significance in diverse financial domains. Luehrman (1997) emphasizes the necessity of understanding the value of an asset and the factors influencing it, underscoring its fundamental requirement for making informed decisions. Damodaran (2006) expands on this by stating that having a grasp of valuation has become essential for making meaningful contributions to a company's decisions regarding resource allocation. Moreover, conducting a company’s valuation helps recognize sources of economic value creation and destruction (Fernández, 2007).

As per Koller (2015), companies create value by investing capital to generate future cash flows with rates of return exceeding their cost of capital. The combination of growth and return on invested capital in relation to its cost is the driving force behind value. This principle is referred to as the conservation of value corollary, emphasizing that anything not contributing to increased cash flows fails to create value.

Moreover, the valuation process is inherently influenced by three core elements: cash, timing, and risk. Each unique problem type possesses structural characteristics that distinguish it from others, introducing specific analytical challenges (Luehrman,1997).

Considering the significance of valuation in numerous financial operations, various methods are employed for the valuation process. There are diverse methodologies for estimating value, ranging from the straightforward to the intricate. Despite the variety of methods available and the differing assumptions they may employ, these models share common characteristics and can be broadly classified. This categorization aids in understanding their place in the overall framework, explaining variations in results, and identifying fundamental errors in logic (Damodaran, 2012).

While the methods used in valuation may appear quantitative, the valuation process itself is not entirely objective. The analyst's preconceptions and biases can unavoidably impact the determined value. Therefore, it is crucial to acknowledge that even the most meticulous valuation efforts result in an estimated value, with a notable chance of potential inaccuracies in the assessment (Damodaran, 2002).

Nevertheless, Damodaran (2002) outlines three approaches to valuation. The first is Discounted Cash Flow approach, which connects the value of an asset to the present value of anticipated future cash flows. The second is Relative Valuation, where the value of an asset is estimated by comparing it to similar assets based on a common variable like earnings, cash flows, book value, or sales. The third is Contingent Claim Valuation, which employs option pricing models to assess the value of assets that exhibit option-like characteristics.

The upcoming sections of this chapter will predominantly focus on the DCF method, specifically highlighting the Free Cash Flow to the Firm, and the Relative Valuation approach using Multiples. These two methodologies serve as the basis for the Equity Valuation presented in this report.

1.2. Discounted Cash Flow Valuation

According to Luehrman (1997), this method consists in a relationship between present value and future value. As aforementioned DCF is one of the main valuation methods, and its widespread use is attributed to its recognition as the only conceptually correct valuation approach (Fernández, 2007). Furthermore, this method serves as the foundation for developing all other valuation methods – including Relative Valuation – which emphasizes that anyone who grasps its basics can analyze and apply different approaches (Damodaran, 2012).

According to Damodaran (2006, 2012) the DCF method is based on the expectation of future cash flows from invested assets, grounded in the present value rule. In these techniques, businesses are considered cash flow generators, and their value is determined by calculating the present value of expected cash flows discounted at a rate reflective of their associated risk level. Determining the discount rate is a crucial step in the valuation process, and it significantly affects the final valuation (Fernández, 2007). Moreover, the discount rate considers the estimated cash flow risk, being higher for riskier assets and lower for safer projects.

When utilizing this model, a universal approach for cash flow discounting can be employed across various methods, beginning with the following expression:

$$Value = \sum_{t=1}^{n} \frac{CF_t}{(1+r)^t} + \frac{TV_n}{(1+r)^n} \quad (1)$$

where,

- CF_t = Cash Flow generated by the company at period t
- r = appropriate discount rate for the cash flow's risk
- TV = Terminal Value, considering a perpetual duration of cash flows and a constant growth rate after year n
- t = period of the respective cash flow
- n = period corresponding to the last forecasted cash flow

DCF valuation can be approached in two ways depending on the characteristics of the cash flows being discounted: the Free Cash Flow to the Firm (FCFF) and the Free Cash Flow to Equity (FCFE). As per Steiger (2008), in the FCFF method, the cash flow is the one available to debt and equity holders, while in the FCFE the cash flow is the one available to the company's equity holders only.

The FCFF method employs a two-step valuation approach. Initially, the enterprise value (EV) is computed, which means, the entire business value, encompassing existing and growth assets is computed. Subsequently, the equity value (EQV) is determined by adjusting the enterprise value, incorporating non-operating assets, and deducting debt.

In contrast, the FCFE method values only the equity stake in the business, discounting all remaining cash flows for shareholders, resulting in the immediate calculation of EQV.

Another distinction lies in the method of discounting cash flows. In the FCFF, cash flows are discounted using the Weighted Average Cost of Capital (WACC) as the discount rate, while in the FCFE, the discount rate employed is the cost of equity (r_e).

Given that an acquirer typically assumes all liabilities, including debt and equity, the Free Cash Flow to the Firm is more pertinent than the equity approach.

Despite these differences, it is possible to shift from the FCFF approach to the FCFE approach by deducting the value of all non-equity claims from the total firm value, as suggested by Damodaran (2006). This implies that, when carried out accurately, the valuation should remain consistent, regardless of the assessment method used, whether it is direct or indirect.

1.2.1. Free Cash Flow to the Firm

As per Damodaran (2002), the FCFF approach values the entire business, representing the cash flow available to both debt and equity holders. It includes the tax benefits of debt and any associated expected risks. The business value is calculated by discounting the FCFF using the WACC, which considers the proportional weight of different financing components based on their market value. Various methods exist for calculating FCFF, but they will yield the same value.

Equation (2) presents the FCFF's primary formula:

$$FCFF = EBIT * (1 - t) + D\&A - CAPEX - \Delta WC \quad (2)$$

where,

- EBIT = Earnings Before Interests and Taxes
- t = Corporate Tax Rate
- D&A = Depreciation and Amortization
- CAPEX = Capital Expenditures
- ΔWC = Changes in Working Capital

The FCFF calculated in equation (2) addresses any obligations to lenders and preferred stockholders. Essentially, taxes and reinvestment requirements are deducted from EBIT to arrive at an estimate for FCFF. It is important to note that FCFF does not include the direct tax benefits from interest payments. However, the cost of capital incorporates these tax shields, as the after-tax cost of debt reflects the interest deductibility (Damodaran, 2006).

(Mota, 2020) FCFF represents the cash flows generated by a company's operating activities, excluding financing activities like interest payments and capital repayments. Additionally, it excludes non-essential investing activities, focusing only on necessary capital expenditures required for maintaining and growing core operations. Proceeds from the sale of unrelated assets or funds used for acquiring unrelated companies are not included.

1.2.1.1. Enterprise Value

As previously mentioned, the first step when using the DCF – FCFF method, relies on the computation of the enterprise value. According to Mota (2020), the EV represents the present value of the company's future cash flows extending infinitely into the future under the assumption of the company's ongoing operations. In simple terms, EV is the present value of the perpetual stream of the free cash flow to the firm discounted by WACC.

The Enterprise Value is represented as follows:

$$EV = \sum_{t=1}^{n} \frac{FCFF_t}{(1+WACC)^t} + \frac{TV_n}{(1+WACC)^n} \quad (3)$$

where,

- EV = Enterprise Value
- $FCFF_t$ = Free Cash Flow to the Firm at period t
- $WACC$ = Weighted Average Cost of Capital
- TV_n = Terminal Value, considering a perpetual duration of cash flows and a constant growth rate after year n

Equation (3) can be divided into two different periods. The first period pertains to all the forecasted periods, encompassing both yearly specific estimations and multiple growth rates designated for a medium-term duration. The subsequent section encompasses the Terminal Value (TV) discounted at the WACC, and it denotes a time frame where a constant annual growth rate for the cash flow of the company is assumed, persisting indefinitely from the conclusion of the final forecasted period.

Mota (2020) asserts that the importance of the second section should be highlighted, given its pivotal role as the fundamental factor in determining the EV. Consequently, it significantly contributes to the overall valuation of the company. Hence, any suppositions made regarding this element have a profound impact on the value of the company.

The Terminal Value represents the discount value at the end of the explicit forecast period, of all future cash flows in perpetuity growing at a constant growth rate (g). It is used to estimate the value of a company beyond the explicit forecast period. The TV can be calculated based on Equation (4):

$$TV_n = \frac{FCFF_{n+1}}{(WACC - g)} \quad (4)$$

where,

- TV = Terminal Value
- $FCFF_{n+1}$ = The first Free Cash Flow to the Firm of the perpetuity
- $WACC$ = Weighted Average Cost of Capital
- g = Constant Growth Rate in perpetuity

The TV embodies the sum of forthcoming cash flows extending beyond a defined forecast duration. TV models play a pivotal role in depicting the value generated throughout the ongoing value phase, and infusing fundamental structural dynamics of the firm into these models offers valuable insights into the significance of growth rates and ensures the accurate estimation of terminal values.

There are some aspects to keep in mind when choosing the perpetual growth rate. As defined by Damodaran (2002), a stable growth model such as the DCF-FCFF can only be used to value a company that is growing at a rate it can sustain in perpetuity. As such, there are some rules to follow: the first one is that the growth rate cannot be higher than the growth rate in the economy; secondly, the firm's characteristics also need to be consistent with the assumptions of stable growth (Damodaran, 2002).

1.2.1.2. Weighted Average Cost of Capital

According to Mota (2020) as the FCFF represents the cash flow available for paying creditors and shareholders, the discount rate should indeed reflect the cost of all external funds, debt, and equity.

As aforementioned, the WACC is a crucial input factor in the DCF model, as it is the rate used to discount the cash flows. To determine the discount rate, thorough analysis of the company's financing structure and the current market conditions is necessary. It is important to note that even minor alterations in the WACC can lead to significant fluctuations in the firm's value.

For the analysis of a prospective buyer considering a new financial strategy or having access to funds at a different cost, a targeted WACC might be more appropriate, although the current WACC, considering the maintenance of the existing capital structure, can also be used.

The current WACC is represented by the following formula:

$$WACC = \frac{E}{E+D} * r_e + \frac{D}{E+D} * r_d * (1 - t) \quad (5)$$

where,

- E = Market value of Equity
- D = Market value of Debt

- r_e = Cost of Equity
- r_d= Cost of Debt
- t = Corporate tax rate

The WACC, as shown in Equation (5), is calculated by assigning weights to the different sources of capital according to the company's financial structure and multiplying them by their respective costs. The WACC represents a blended rate of the cost of debt and the cost of equity, weighted based on their contributions to the company's overall financing. In the DCF-FCFF method, WACC is the appropriate discount rate because, when valuing the entire firm (including both debt and equity), it is essential to consider the expected returns on both debt and equity in proportion to their roles in the company's capital structure (Fernández, 2007).

1.2.1.3. Cost of Equity

As previously mentioned, a crucial element in determining the WACC is the cost of equity. According to Damodaran (2006), the cost of equity represents the rate of return demanded by investors to make an equity investment in a company. The author emphasizes that the cost of equity holds significant importance in discounted cash flow models. However, estimating this cost poses challenges because it is not explicitly stated and can differ significantly among various investors in the same company.

Investors often anticipate specific returns when acquiring assets, envisioning gains realized over the duration they hold the asset. However, the actual returns during this period can deviate significantly from expectations, introducing risk into the investment equation. Risk measures are employed to estimate the expected return on equity investments, which can be viewed as the cost of equity for a company. Thus, while investors anticipate certain returns, the variability inherent in investments underscores the importance of understanding and managing risk in the pursuit of these anticipated returns.

According to Damodaran (2008a) regarding risk, there exists several models, sharing common assumptions. First, risk is defined as the variability or deviation of actual returns from the expected return. A riskless investment is one where actual return consistently match the expected return. Second, risk should be evaluated from the viewpoint of the marginal investor, who is assumed to be well diversified.

The argument posits that only the risk contributed by an investment to a diversified portfolio warrants measurement and compensation. Consequently, this perspective leads to the division of investment risk into two components: firm-specific risk, which pertains solely to the individual investment or a small group of similar investments, and market risk, which affects a broader subset or all investments. While firm-specific risk can be diversified away, market risk, representing non-diversifiable risk, remains uncompensated and should be rewarded.

While there is a consensus that risk stems from the distribution of actual returns around the expected return and should be evaluated from the perspective of a well-diversified investor, there is divergence in opinion regarding the measurement of non-diversifiable or market risk and the reasons behind these differences. Despite the existence of multiple models for measuring market risk, the capital asset pricing model (CAPM) remains the default choice for this purpose.

In broader terms, the model necessitates three inputs for calculating expected returns: a risk-free rate, an asset's beta, and an anticipated risk premium for the market portfolio (in addition to the risk-free rate).

According to Womack and Zhang (2003) the CAPM model endeavors to measure the connection between an asset's beta and its expected return. This model relies on simplifying assumptions, notably concerning investor conduct and the existence of a singular common risk factor. Its continued dominance in real-world applications underscores its intuitive appeal and the failure of more complex models to significantly enhance the estimation of expected returns. The judicious application of the CAPM remains the most effective method for addressing risk in valuation. (Damodaran, 2006).

Considering the relationship between expected returns and assets' exposure to market risk, it leads us to the formulation of the CAPM equation:

$$r_e = r_f + CRP + \beta_L * \left[E(R_m) - r_f\right] \quad (6)$$

where,

- r_e = Cost of Equity
- r_f = Risk-free Rate
- CRP = Country Risk Premium
- β_L = Beta Levered
- $E(R_m)$ = Expected Market Return
- $E(R_m) - r_f$ = Market risk premium

In essence, according to the CAPM, an asset's expected return is the sum of the risk-free rate and a compensation for the risk it carries, quantified by the asset's beta. Beta, in turn, measures the ratio of an asset's expected excess return compared to the overall market's excess return.

1.2.1.4. Risk-free Rate

According to Damodaran (2006, 2008c) risk is perceived as the fluctuation in actual returns relative to the expected return. For an investment to be considered risk-free within this framework, it is essential that the actual returns consistently align with the expected return. Additionally, a risk-free investment should exhibit returns that show no correlation with the performance of risky investments in the market.

Therefore, for an investment to qualify as risk-free, meaning the actual return equals the expected return, two conditions must be satisfied:

1. There should be no default risk, typically necessitating the security to be issued by a government;
2. There should be no uncertainty concerning reinvestment rates, implying the absence of intermediate cash flows.

In considering risk-free rates, a theoretical approach advocates for using distinct rates for cash flows in each period and varying expected returns (Damodaran, 2006). However, in practice, the impact of varying risk-free rates across periods is often minimal, especially for well-structured term frameworks. A practical compromise involves employing a duration matching strategy, aligning the duration of the risk-free asset with the cash flow durations. For valuations extending over prolonged periods or to infinity, it is advisable to predominantly utilize long-term rates as risk-free rates, such as the 10-year government bond rate. Additionally, the choice of risk-free rate should align with the currency in which cash flows are estimated rather than the domicile of the asset or firm.

1.2.1.5. Market Risk Premium

According to Damodaran (2008b) the market risk premium (MRP) represents the fundamental assessments regarding the level of risk present in an economy or market, and the corresponding value assigned to that risk. This judgment influences the expected return on every risky investment and impacts the valuation of each investment. As a result, it plays a crucial role in determining how we distribute wealth among various asset classes and which specific assets or securities we select within each asset class.

The market risk premium as part of the CAPM can be broken down as follows:

$$MRP = E(R_m) - r_f \tag{7}$$

The expected return on an investment depends on two main factors, the investor risk aversion where investors that are more risk-averse, require typically a higher premium for moving away from risk-free assets and the risk level of the investment.

In practice, the market risk premium is usually estimated by looking at the historical premium earned by stocks over default-free securities over long time periods. This approach might yield reasonable estimates in markets like the United States, with a large and diversified stock market and a long history of returns on both stocks and government securities. However, they yield meaningless estimates for the risk premiums in other countries, where the equity markets represent a small proportion of the overall economy, and the historical returns are available only for short periods.

1.2.1.6. Beta

In the CAPM, an investment's beta represents the additional risk it contributes to a market portfolio (Damodaran, 2002).

As mentioned earlier, financial models concerning risk and return necessitate assessing a firm's exposure to market risk compared to its peers. The conventional method for gauging this relative risk involves regressing stock returns against a market index. Although these regression betas can be adjusted to incorporate financial fundamentals, alternative measures of relative risk exist that do not rely on regression, such as the bottom-up approach.

While there are various techniques available to estimate beta, Damodaran (2002, 2006) proposes that the bottom-up beta approach stands out as superior. In this method, a firm's beta is calculated as a weighted average of the betas of all the diverse businesses it operates in. The author presents three justifications for this claim:

1. It allows for proactive consideration of changes in business and financial compositions;
2. It relies on average betas across multiple firms, typically resulting in lower volatility compared to individual firm betas;
3. It facilitates the computation of betas by business sector for a company, providing practicality in both investment analysis and valuation scenarios.

This approach consists of several steps:

1. Determine a benchmark for the levered beta - β_L – by utilizing either a peer group average or industry average that shares similar characteristics to the target company;
2. Estimate the unlevered beta – β_U - using the data from the chosen benchmark. Under the assumption that the selected peer group bears identical business risk as the target company, consider this average as equivalent to the company's unlevered beta;
3. Compute the levered beta using data from the company.

The β_U solely reflects the business risk whereas the β_L encompasses both financial and business risk. Consequently, it is opted to estimate the β_U using peer group data rather than estimating the β_L, as the financial structure of the companies may diverge.

Once the appropriate benchmark has been selected, the interconnections among betas— unlevered, levered, and debt— will be utilized as elaborated below:

$$\beta_U = \frac{\beta_L + \beta_D * \frac{D}{E} * (1 - t)}{1 + \frac{D}{E} * (1 - t)} \quad (8)$$

$$\beta_D = \frac{r_d - r_f}{MRP} \quad (9)$$

$$\beta_L = \beta_U + (\beta_U - \beta_D) * \frac{D}{E} * (1 - t) \quad (10)$$

where,

- β_U = Unlevered Beta
- β_L = Levered Beta
- β_D = Debt Beta
- $\frac{D}{E}$ = Debt-to-equity ratio
- t = Corporate Tax Rate
- r_d = Cost of debt
- r_f = Risk-free rate
- CRP = Country Risk Premium
- MRP = Market Risk Premium

1.2.1.7. Cost of debt

An additional element necessary for calculating the WACC is the cost of debt. The cost of debt measures the present expense incurred by the company when obtaining funds to support its assets. It reflects both the company's default risk and prevailing market interest rates (Damodaran, 2014). The cost of debt is often divided into pre-tax and after-tax categories. The after-tax cost of debt takes into account the tax advantages linked to the company's debt obligations.

Since interest is tax deductible, the after-tax cost of debt is a function of the tax rate. The tax benefit that accrues from paying interest makes the after-tax cost of debt lower than the pretax cost. Furthermore, this benefit increases as the tax rate increases.

$$After\ tax\ Cost\ of\ Debt = Pre\ tax\ Cost\ of\ Debt * (1 - t) \quad (11)$$

$$r_D = \ Pre\ tax\ Cost\ of\ Debt = r_f + default\ spread \quad (12)$$

Although interest is tax deductible, the return to investors and other sources of capital are not, so concerning the Pre-tax Cost of debt, it is calculated by adding the risk-free rate to the default spread. This spread represents the variance between the yields of a corporate bond and a risk-free bond of similar maturity.

As per Damodaran (2006) when a company has multiple long-term bonds in circulation, frequently traded and liquid, their market prices, coupled with their coupons and maturity, can be utilized to compute a yield, serving as the cost of debt. Nevertheless, in cases where bonds are not regularly traded and firms possess credit ratings, the cost of debt can be estimated using these ratings and their corresponding default spreads. For instance, a firm with an A rating might anticipate a cost of debt approximately 1 pp higher than the Treasury Bond Rate, a common spread for AA-rated firms.

When no rating exists to gauge the cost of debt, two alternatives are available: analyzing recent borrowing history or creating an estimated synthetic rating and default spread.

1.2.1.8. Equity Value

Upon implementing the aforementioned concepts to calculate the Enterprise Value, the value of the business is assessed. The Equity Value represents the business's worth along with the proceeds from selling assets not essential for operations, subtracting the company's debts.

$$EQV = EV + Non\text{-}Operating\ Assets - Debt \quad (13)$$

According to Mota (2020) non-operating assets encompass all types of company-owned assets, whether current or non-current, that are not utilized in its core business activities. These assets have no bearing on the company's future performance, as reflected in its enterprise value.

Debt, on the other hand, encompasses all company liabilities excluding those included in working capital. While ideally, debt should be assessed by its market value, accounting values are commonly used, albeit increasingly aligning with market values. This debt comprises interest-bearing liabilities and other non-operating obligations, such as legal claims and provisions, not utilized for operational or working capital financing.

1.2.1.9. Growth Rate

According to Damodaran (2002), the value of a company is determined by the present worth of anticipated future cash flows it generates. Estimating growth is crucial in valuation, particularly for high-growth firms. However, it is essential to note, as emphasized by Damodaran (2008), that value creation is not solely dependent on growth itself, but rather on growth accompanied by positive excess returns. Increased growth can either enhance value, diminish it, or maintain it unchanged.

According to Damodaran (2008) and Koller (2020), for companies to enhance their value, they must invest capital in ways that yield future cash flows surpassing their cost of capital. As previously mentioned, the ability to grow rapidly and allocate capital efficiently at attractive returns is pivotal for value creation. The combination of growth and return on invested capital in comparison to the cost of capital determines the creation of value. Ultimately, the value a company generates depends on its ROIC, revenue growth, and its ability to sustain these factors over time.

There are three main methods for estimating growth in any company. Firstly, one can examine the company's historical earnings growth rate. While this approach is beneficial for stable firms, it may not be reliable for high-growth companies due to uncertainties and limitations. Secondly, analysts' estimates of growth for the company can be considered. However, relying solely on analyst forecasts may result in inaccurate valuations due to the poor quality of long-term growth estimates. Thirdly, growth can be estimated based on the company's fundamentals. This involves analyzing how much the company reinvests in new assets and the quality of these investments, such as acquisitions or expanding marketing efforts. This can be evaluated by analyzing metrics like return on equity, return on invested capital, and the reinvestment rate. According to Damodaran (2002), this method is the

most reliable for estimating growth, as it essentially entails estimating the company's fundamental growth rate by assessing these factors.

The three methods adhere to two fundamental principles: firstly, they acknowledge a cause-and-effect relationship between growth and reinvestment. Secondly, they concur that the most effective gauge of growth quality is evaluating the returns generated from the company's investments.

1.3. Relative Valuation

In Relative Valuation, as described by Damodaran (2002), an asset's value is determined by comparing it to similar assets using common metrics like earnings, cash flows, book value, or revenues. According to Mota (2020), it is essential for a metric to have a logical connection to the observed market value to be meaningful.

When employing multiples to value a company, as outlined by Mota (2020), there are two primary options: either pinpoint a specific company that shares similar characteristics with the one under evaluation or form a peer group, which is the more prevalent choice.

The peer group consists of companies deemed sufficiently comparable to the company being valued, typically chosen from the same industry. Regardless of the approach, whether selecting an individual company or forming a peer group, the decision holds significant importance in this valuation method.

When using a peer group, the multiples used in the valuation are typically averaged from the peer group. However, as no two businesses are identical, adjustments may be made to individual observed multiples to make the data more comparable. Sometimes, a company may be excluded from the peer group for a specific multiple if its observed value significantly deviates from a reasonable range for some reason.

Often, multiple multipliers are utilized in the valuation process, and ultimately, either an average of the values derived from each multiplier is utilized, or an interval for the company's value is established.

Damodaran (2006) highlights a significant philosophical distinction between DCF and Relative Valuation. In DCF, the focus is on estimating intrinsic value based on future cash flow potential, whereas in Relative Valuation, judgments are made by observing market prices for similar assets. If the market accurately prices assets on average, DCF and Relative Valuations may align. However, if the market systematically over or under prices assets or sectors, DCF and Relative Valuation may differ.

Additionally, Damodaran (2006) suggests that while DCF seeks intrinsic value (albeit imperfectly), Relative Valuation relies on trusting market efficiency. The simplicity and relatability of multiples make

them appealing for most valuations. They provide quick estimates, especially when numerous comparable firms are available, and when the market accurately prices them.

Nevertheless, this simplicity can lead to inaccuracies in estimating a company's value by overlooking factors like risk, growth, and cash flows, as mentioned by Fernández (2001). Therefore, some financial experts advocate using relative valuation in a subsequent phase of valuation. Following the valuation using another method, comparing the multiples of similar firms allows us to assess the valuation conducted and pinpoint disparities between the valued firm and its counterparts (Fernández, 2001; Mota, 2020).

1.3.1. Multiples

Based on the sector under scrutiny, specific multiples may be more suitable than others. Fernández (2001) categorizes multiples into three distinct groups:

1. Equity Value Multiples: Multiples based on the company's capitalization;
2. Enterprise Value Multiples: Multiples Based on the company's value;
3. Growth-referenced multiples.

Table 1.1: **Multiples**. Adapted from Fernández.

Equity Value Multiples	• Price to Earnings Ratio (P/E) • Price to Sales (P/S) • Price to Book Value (P/BV)
Enterprise Value Multiples	• Enterprise Value to EBITDA (EV/EBITDA) • Enterprise Value to Sales (EV/Sales) • Enterprise Value to Free Cash Flow (EV/FCF)
Growth-Referenced Multiples	• PER to EPS growth (P/EG) • Enterprise Value to EBITDA growth (EV/EG)

According to Fernández (2001), equity value multiples are derived from a company's capitalization or price, offering the advantage of being easily understandable and calculable. Damodaran (2006) suggests that one of the most intuitive approaches to assess the value of any asset is by considering it as a multiple of the earnings it generates. The Price-to-Earnings ratio stands out as one of the most used multiples. The Price-to-Sales ratio finds frequent application in valuing internet companies, telecommunications infrastructure companies, bus companies, and pharmacies. The Price-to-Book Value ratio can exhibit significant variations across industries, contingent upon their growth potential

and investment quality. Moreover, it is commonly employed in valuing banks, the paper and pulp industry, real estate, and insurance.

As previously mentioned, Enterprise Value multiples are those rooted in the overall value of the company. These multiples resemble equity value multiples but differ in their utilization of enterprise value instead of market capitalization. When acquiring a business rather than just its equity, it's customary to assess the firm's value as a multiple of its operating income or EBITDA. While a lower multiple is preferable to a higher one for buyers of equity or the firm, these multiples are influenced by the growth potential and risk associated with the acquired business. Like the P/E ratio, EV/EBITDA is among the most commonly used multiples, although it has limitations such as not accounting for changes in working capital requirements and capital investments. Growth-Referenced Multiples find primary application in industries characterized by rapid growth, such as luxury goods, healthcare, technology, and telecommunications.

2. Company overview

The purpose of this chapter is to provide a comprehensive overview of Starbucks, detailing the company's history, business strategy, and key operational segments. This section will also explore its financial performance, market position, and other critical aspects that define its competitive edge and long-term growth prospects.

2.1. Company History

Starbucks Corporation, along with its subsidiary companies, is commonly known as "Starbucks", and it was founded in 1971 with a simple mission: to share excellent coffee and make the world a better place. This philosophy has been the cornerstone of the company since its first store opened in Seattle's Pike Place Market. Initially a small shop, Starbucks quickly gained a reputation for offering top-quality fresh-roasted whole bean coffee. The name "Starbucks," inspired by “Moby-Dick”, evokes the adventurous spirit of seafaring and the early coffee trade.

Starbucks was designed to be more than just a coffee shop; it aimed to create a sense of community, providing a "third place" between work and home where people could connect and converse. This unique approach sets Starbucks apart from other coffee companies. Today, Starbucks has over 32,000 stores in 80 countries, making it the leading roaster and retailer of specialty coffee. Despite its global reach, Starbucks remains committed to its roots, striving to deliver an extraordinary coffee experience with every cup.

Starbucks sells handcrafted coffee, tea, and other beverages, along with a selection of high-quality food items, in its company-operated stores. The company also offers various coffee and tea products and licenses its trademarks through different outlets, such as licensed stores, as well as grocery and foodservice via their Global Coffee Alliance with Nestlé S.A. ("Nestlé"). Besides their main Starbucks Coffee brand, the company markets goods and services under other brands, including Teavana, Ethos, Starbucks Reserve, and Princi.

Starbucks operates through three main segments: North America (covering the United States and Canada), International (covering China, Japan, Asia Pacific, Europe, Middle East, Africa, Latin America, and the Caribbean), and Channel Development. The North America and International segments sell coffee, other beverages, complementary food, packaged coffees, single-serve coffee products, and select merchandise through both company-operated and licensed stores. The Channel Development segment focuses on selling packaged coffee, tea, and ready-to-drink beverages to customers outside of its stores.

According to Starbucks (2023), Starbucks employs around 381,000 people globally, with 228,000 in the U.S. and 153,000 internationally, mainly in company-operated stores. This workforce size

underscores the company’s vast operational scale and its ability to manage such a large, distributed team. Starbucks has reported improved employee retention and lower turnover in 2023, indicating effective workforce management—a key factor in maintaining operational efficiency and consistent customer service across its locations.

In terms of financial scale, Starbucks' market capitalization stood at approximately $115 billion in late 2023 (Starbucks, 2023), positioning it as a leader in the global retail coffee industry. This scale, combined with its workforce, illustrates the company’s robust business model and global influence.

2.2. Company Business Strategy

Starbucks Corporation aims to remain one of the most recognized and respected brands in the world. The company believes that steady growth in revenue and profits can be achieved by continually investing in its brand and operations. This strategy involves expanding their global presence by opening new stores, not just in established markets like the U.S., but also in fast-growing regions like China. Moreover, they are optimizing the balance between company-owned and licensed stores on a global scale (Starbucks, 2023).

Starbucks Corporation's global business strategy heavily depends on various business partners, including licensees, joint ventures, third-party manufacturers, distributors, and retailers, especially for its global Channel Development operations. These partners are key to implementing Starbucks' strategy for new stores, branded products, and other business initiatives.

2.3. Shareholder Structure

Starbucks Corporation first went public during its Initial Public Offering in June 1992 (Starbucks, n.d.). Today the company’s shareholder structure is dispersed and a mix of institutional, retail and individual investors. Under the symbol “SBUX”, the Starbucks Corporation stocks are traded on the Nasdaq Global Select Market (“Nasdaq”). According to Starbucks (2023) in November 2023 the company had approximately 18,000 shareholders of record. Approximately 53.27% is owned by Public Companies and Individual Investors, 44.32% of the company's stock is owned by Institutional Investors and 2.42% is owned by Insiders.

2.4. Business Segments

Starbucks has three key operating segments: North America, International, and Channel Development.

- North America, is the most established segment, contributing 74% of the company's total net revenues in 2023;

- International accounting for 21% of total revenues. While some markets in this segment are well-established, others require more support for growth;
- Channel Development represents 5% of total revenues. It encompasses the sale of roasted whole bean and ground coffee, single-serve products branded with Starbucks or Teavana, and various ready-to-drink beverages like Frappuccino and Starbucks Doubleshot. This segment also includes foodservice products and other Starbucks-branded merchandise. Much of the Channel Development business operates through a licensed model with Nestlé's Global Coffee Alliance, while the ready-to-drink business works with partners like PepsiCo and others.

North America and International segments include both company-operated and licensed stores, while Channel Development focuses on product distribution beyond the Starbucks retail environment.

In Figure 2.1, one can see that Starbucks operates a network of both company-owned and licensed stores, with approximately 51% directly owned and the remaining 49% licensed to qualified partners. This mix allows Starbucks to maintain high-quality standards for its products and services while also enabling quick expansion into new markets.

Most of Starbucks' revenue comes from company-operated stores and licensed stores. The number of Starbucks stores owned directly by the company versus those operated by partners can vary in each market. Factors influencing this include access to good retail locations, market potential, profitability, and local support infrastructure.

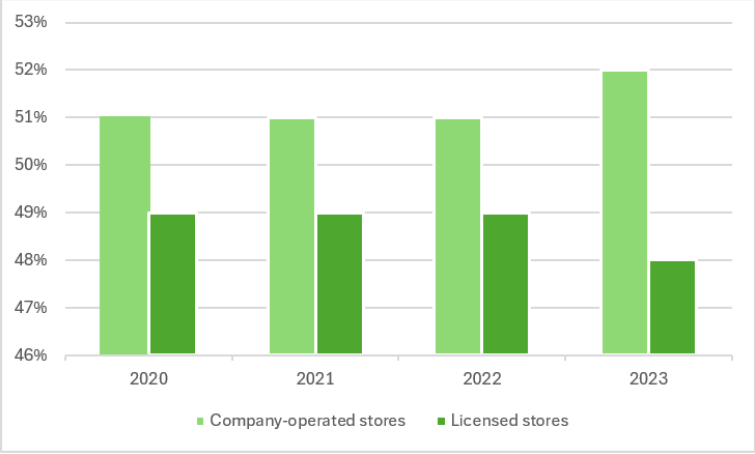

Figure 2.1: **Company-operated stores and licensed stores as a percentage of total stores (%)**. Adapted from Annual Reports Starbucks 2020, 2021, 2022, 2023.

In 2023, 82% of total net revenues came from company-operated stores. Starbucks' retail goal is to be the premier coffee and tea retailer in every target market, offering high-quality products and unique experiences. Starbucks prioritizes superior customer service, convenience, and a seamless digital experience, alongside safe, clean, and community-centric stores. The company's global retail expansion strategy focuses on disciplined category share growth through selective store openings and

increasing sales in existing locations. This approach supports their long-term objective of maintaining Starbucks as one of the world's most recognized and respected brands. Store growth varies by market, considering factors like financial returns, market maturity, economic conditions, consumer behavior, and local business environments.

Figure 2.2 highlights the growth trajectories within these regions over the four-year period. The North American segment shows a relatively stable but gradual increase in the number of stores. In contrast, the international segment exhibits a steadier yet consistently upward trend. Overall, the total number of company-operated stores globally indicates a continuous growth pattern, reflecting Starbucks' strategic expansion and operational focus. This graphical representation provides a clear visual summary of how Starbucks has scaled its company-operated store presence in different markets over the recent years.

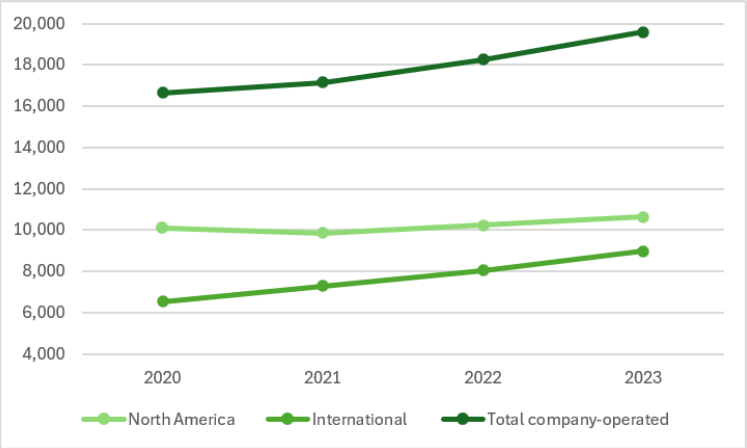

Figure 2.2: **Company-operated store data ($, in millions).** Adapted from Annual Reports Starbucks 2020, 2021, 2022, 2023.

Starbucks strategically locates its company-operated stores in high-traffic, visible areas, adjusting their size and design to fit different environments, such as city centers, suburbs, office buildings, universities, and rural areas. The company is expanding its focus on drive-thru locations to increase accessibility and convenience, along with simplified store formats designed to improve the customer experience in urban locations. In 2022, Starbucks introduced the "Reinvention Plan" in the U.S., aimed at improving operational efficiency while boosting both employee and customer satisfaction. By investing in employee wages and training, Starbucks has seen improvements in retention and productivity. Additionally, innovations such as specialized store designs and cutting-edge technologies are enhancing convenience and customer engagement. Globally, Starbucks is focusing on technology partnerships to drive digital growth and improve customer service. The company has adopted an omni-channel strategy, providing customers with multiple service options through online platforms, e-commerce, delivery, and mobile ordering, in addition to traditional in-store interactions. In China, Starbucks combines physical and digital elements through initiatives like Starbucks Now stores, which

allow customers to pre-order and collect their items easily. These strategies reflect the growing demand for mobile ordering, contactless payments, and reduced in-store wait times. Starbucks continues to invest in digital advancements, offering members additional benefits and more engaging coffee experiences, all aimed at increasing customer satisfaction and ensuring long-term growth.

In 2023, the product distribution in company-operated stores is as follows: beverages account for 74% of sales, food represents 22%, and the remaining 4% consists primarily of serveware, packaged and single-serve coffees and teas, ready-to-drink beverages, and other miscellaneous products. This breakdown is illustrated in Figure 2.3.

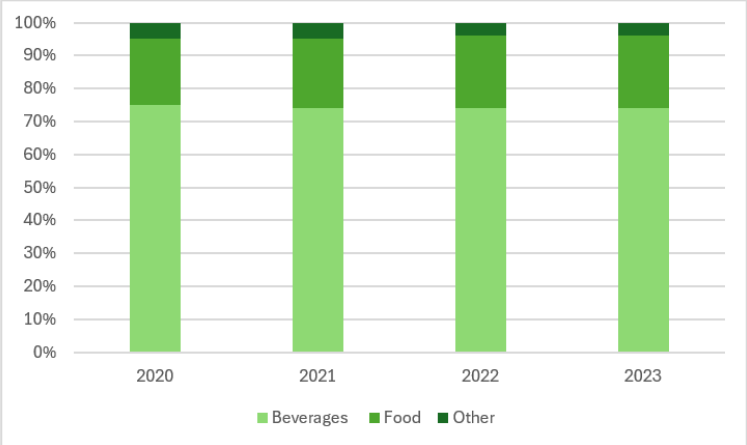

Figure 2.3: **Retail sales by product type for company-operated stores (%).** Adapted from Annual Reports Starbucks 2020, 2021, 2022, 2023.

Shifting focus to the licensed stores, in 2023, licensed stores contributed 13% of total net revenues. These stores typically have lower gross margins, but higher operating margins compared to company-operated stores. Starbucks earns a margin on branded products and supplies sold to licensees, along with royalties on retail sales. Licensees handle operating costs and investments, offsetting lower revenues for Starbucks. The company collaborates with local partners to utilize their expertise and gain access to desirable retail locations. Most licensees are experienced retailers with market knowledge. Starbucks sells products to licensees for resale and provides equipment. Licensee employees follow Starbucks' operating procedures and training similar to company-operated stores. In some international markets, traditional franchising is used, included in results with other licensed stores.

Figure 2.4 highlights the growth patterns within these regions over the four-year period. The data reveals that the number of licensed stores in North America has remained relatively stable. In contrast, the International segment shows a steady increase, contributing significantly to the overall growth of licensed stores globally. This graphical representation provides a clear view of Starbucks' strategy and performance in expanding its licensed store footprint worldwide.

Other revenue sources primarily come from the Channel Development segment, which involves selling packaged coffee, tea, and ready-to-drink beverages to consumers outside their stores. This also includes royalty income from collaborations with Nestlé and other partnerships through the Global Coffee Alliance.

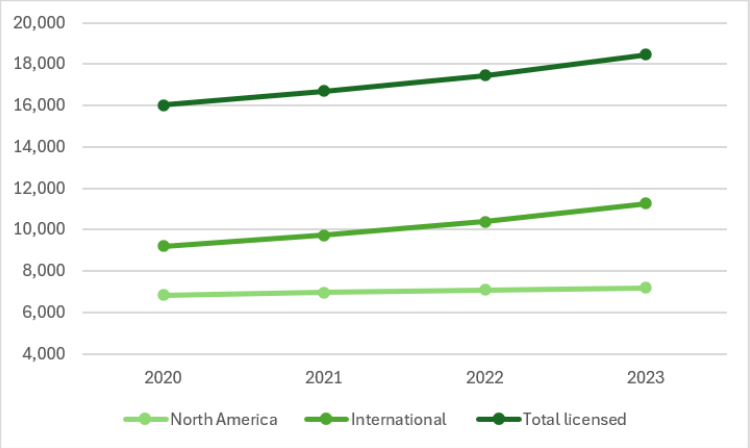

Figure 2.4: **Licensed store data ($, in millions)**. Adapted from Annual Reports Starbucks 2020, 2021, 2022, 2023.

2.5. Financial Analysis

Starbucks operates in fiscal year from October 1 to September 30. The company's financial performance and sustainable growth hinge on expanding new stores, enhancing sales at existing locations, and effectively managing profit margins. These critical metrics are used by management to gauge business growth and strategy effectiveness, providing valuable insights for investors. The Management Discussion and Analysis (MD&A) emphasizes key indicators such as:

- New store openings and total store count;
- Comparable store sales;
- Operating margin.

Over the period from 2020 to 2023, Starbucks has demonstrated a robust performance in its operating activities. Revenues increased steadily from $23.52 billion in 2020 to $35.98 billion in 2023, reflecting a strong growth trajectory. Operational costs also rose, from $22.28 billion in 2020 to $30.49 billion in 2023. Despite the increase in costs, the company managed to maintain a solid EBITDA, which grew from $2.99 billion in 2020 to $7.23 billion in 2023. The EBITDA margin, an indicator of operational efficiency, ranged from 13% in 2020 to a peak of 22% in 2021, before stabilizing at 19% in 2022 and 20% in 2023. This performance illustrates Starbucks' ability to effectively manage its operational costs while driving significant revenue growth and maintaining a healthy profit margin (Figure 2.5).

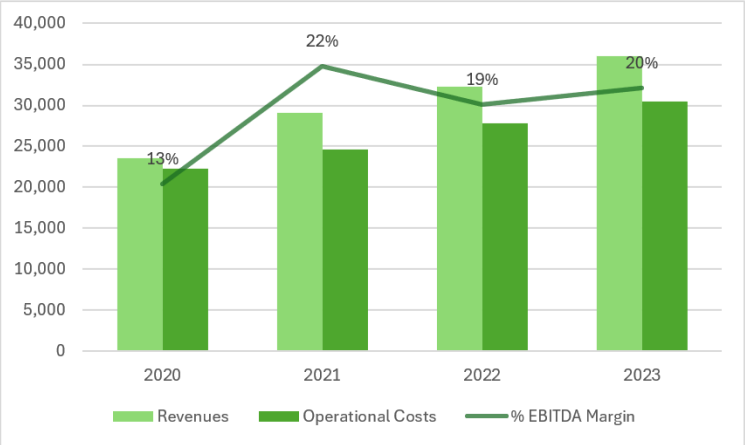

Figure 2.5: **Revenues, Operational Costs, % EBITDA ($, in millions).** Adapted from Annual Reports Starbucks 2020, 2021, 2022, 2023, & own estimates.

According to Starbucks (2023), in 2023, Starbucks achieved notable performance with a 12% increase in total net revenues compared to 2022. This growth was primarily driven by a $2.9 billion rise in sales from company-operated stores, supported by an 8% increase in comparable store sales and a 7% boost from 1,339 new store openings. The North American segment saw a 9% rise in comparable store sales, with a 6% increase in average transaction size. The International segment also contributed with an 8% revenue increase despite early pandemic challenges in China. Additionally, the Channel Development segment grew by 3%, bolstered by higher sales from the Global Coffee Alliance and ready-to-drink products. Revenue from licensed stores increased by $857 million, driven by new store openings and higher royalty revenues. However, some gains were offset by adverse foreign currency effects and a decline in other revenues due to the sale of Evolution Fresh (Figure 2.6).

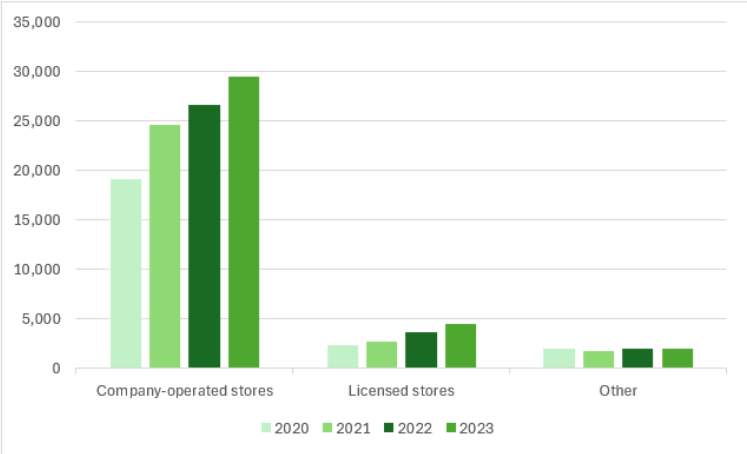

Figure 2.6: **Revenues ($, in millions) from company-operated stores, licensed stores and other.** Adapted from Annual Reports Starbucks 2020, 2021, 2022, 2023.

According to Starbucks (2023), in 2023, product and distribution costs as a percentage of net revenues decreased by 30 basis points, driven by pricing improvements, which were partially offset by

commodity and supply chain inflation. Store operating expenses also saw a reduction of 120 basis points as a percentage of net revenues, thanks to operational efficiencies, sales leverage, and pricing. However, this was partially offset by higher investments in partner wages, benefits, and training. Other operating expenses increased by $78 million due to higher strategic investments in technology and support for licensed markets. Depreciation and amortization expenses decreased by 70 basis points due to the full amortization of acquisition-related intangibles. General and administrative expenses rose by $409.3 million, mainly due to increased spending on technology, strategic initiatives, performance-based compensation, and labor costs (Figure 2.7).

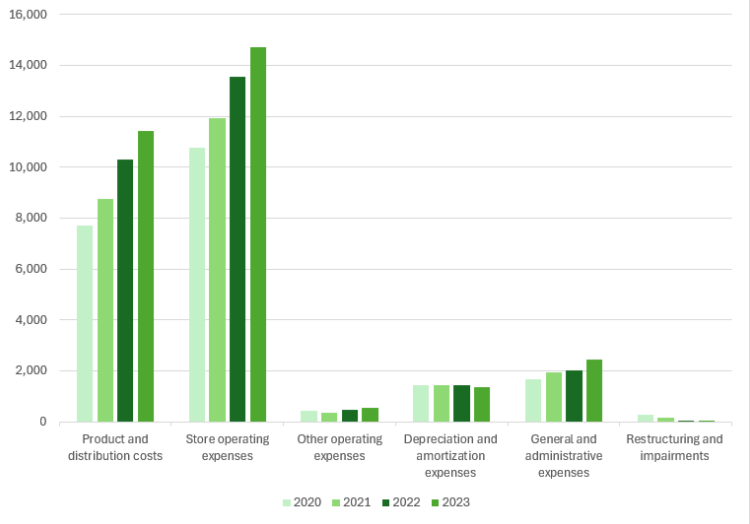

Figure 2.7: **Operating Expenses ($, in millions).** Adapted from Annual Reports Starbucks 2020, 2021, 2022, 2023.

Diluted earnings per share (EPS) climbed to $3.58 in 2023, compared to $2.83 in 2022. The rise in EPS was mainly driven by the combination of sales growth and in-store operational efficiencies, although it was partially offset by the company's commitments to wage increases and higher general administrative expenses. Capital expenditures also increased, reaching $2.3 billion in 2023, up from $1.8 billion in 2022 (Starbucks, 2023).

In terms of shareholder returns, Starbucks distributed $3.4 billion through share repurchases and dividends in 2023, which was lower than the $6.3 billion distributed in 2022. This overall performance reflects the company's focus on balancing growth with returns to shareholders while navigating increased costs and investment commitments (Starbucks, 2023).

2.5.1. Liquidity

Figure 2.8 represents the liquidity ratios of Starbucks revealing a mixed performance in managing its short-term obligations over the period from 2020 to 2023. The current ratio, which measures the company's ability to cover its liabilities using all current assets, remained stable in 2020 and 2021, with

values of 1.06 and 1.20, respectively. However, it dropped to 0.77 in 2022 and 0.78 in 2023, indicating a decline in the company's ability to cover its short-term liabilities. The quick ratio, which excludes inventories, followed a similar trend, falling from 1.00 in 2021 to 0.53 in 2022, and slightly recovering to 0.59 in 2023, highlighting a reduced liquidity cushion. Lastly, the cash ratio, the most conservative liquidity measure, showed a notable decline from 0.79 in 2021 to 0.31 in 2022, before slightly improving to 0.38 in 2023. This indicates that Starbucks has less immediate cash available to cover its current liabilities, though still maintaining some buffer. Overall, the decreasing trend across these ratios signals tightening liquidity conditions in recent years.

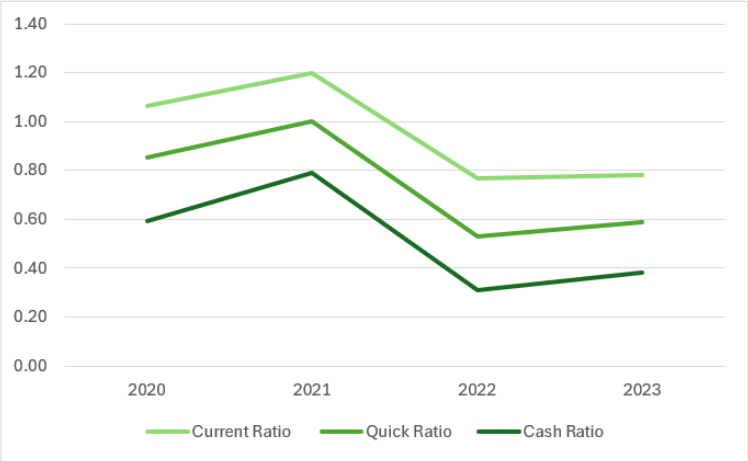

Figure 2.8: Liquidity Ratios. Adapted from Annual Reports Starbucks 2020, 2021, 2022, 2023, & own estimates.

2.5.2. Profitability

The profitability ratios for Starbucks from 2020 to 2023 reflect a period of recovery following the challenges posed by the COVID-19 pandemic, though certain pressures remain evident. The Return on Assets (ROA) shows a consistent improvement, rising from 3% in 2020 to 14% in 2023, indicating a more efficient use of the company's assets in generating profits over this period. Similarly, the Return on Invested Capital (ROIC) improved from 5% in 2020 to 20% in 2023, suggesting that Starbucks has effectively generated returns on the capital it has invested in its operations (Figure 2.9).

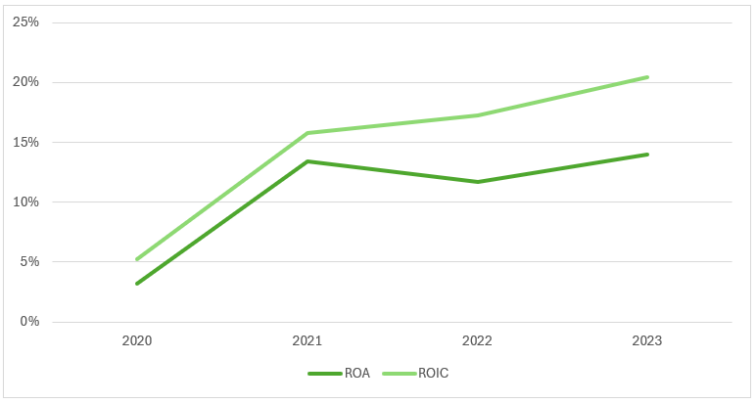

Figure 2.9: **Profitability Ratios.** Adapted from Annual Reports Starbucks 2020, 2021, 2022, 2023, & own estimates.

2.6. Stock Performance

Between 2020 and 2023, Starbucks Corporation (SBUX) exhibited a resilient stock performance despite facing significant global challenges. In early 2020, the stock experienced substantial volatility, plunging from a high of $94.31 in January to a low of $55.79 in March due to the COVID-19 pandemic, which led to temporary store closures and reduced customer traffic. However, Starbucks quickly adapted by enhancing its drive-thru, delivery, and mobile order capabilities, which facilitated a strong recovery (Starbucks 2020, 2021). By mid-2021, the stock reached new highs, peaking at around $126.32 in July, as the company reported robust financial results, including a 24% increase in revenue for fiscal Q3 2021 compared to the previous year. Despite facing inflationary pressures, supply chain disruptions, and labor shortages in 2022, with the stock fluctuating between $76 and $117, Starbucks' continued investment in employee wages, training, and technology under the "Reinvention Plan" helped stabilize its stock price. The International segment, particularly in China, saw a 14% decline in comparable store sales due to ongoing pandemic-related restrictions but overall contributed positively with an 8% revenue increase year-over-year. By the end of 2023, Starbuck’s stock reflected steady growth, closing the year at approximately $112, underpinned by its global expansion strategy and innovative approaches to enhancing customer experience. The company's consistent revenue growth, evidenced by a 12% increase to $36 billion in 2023, strategic store portfolio management, and commitment to sustainability have bolstered investor confidence, positioning Starbucks for long-term sustainable growth (Starbucks, 2023).

3. Market Overview

The market overview provides a comprehensive analysis of Starbucks' global position within the macroeconomic environment and the broader coffee industry. It examines the company's standing in key international markets, highlighting its global expansion and adaptation to varying economic conditions. This section also explores the competitive landscape of the coffee retail industry, identifying Starbucks' major competitors, while discussing the company's competitive advantages, including its strong brand identity, innovative store formats, and focus on sustainability. These elements collectively shape Starbucks' ability to maintain market leadership and drive long-term growth.

3.1. Macroeconomic Outlook

Starbucks' financial and operational performance is exposed to various external risks, including rising real estate costs, inflation, interest rate fluctuations, supply chain disruptions, changes in tax policies, currency exchange volatility, and legal disputes. Additionally, climate change, labor disputes, geopolitical events, and social unrest in key markets like the U.S. and China can significantly impact operations. Economic downturns could also affect suppliers and licensees, potentially leading to financial strain or insolvency, which might require Starbucks to provide financial assistance, affecting its resources and reputation.

Starbucks' future growth heavily depends on key international markets maintaining stable revenue and earnings. Economic downturns in these regions, particularly China—a critical driver of global profits—could negatively impact overall performance. The company faces risks such as U.S.-China relations, competition, economic instability, regulatory changes, and food safety concerns. International operations also contend with local preferences, higher costs, and regulatory compliance, especially in developing markets where early-stage expansion increases operational expenses.

Operating in 86 markets brings additional challenges, including currency fluctuations, changing legal and economic conditions, trade regulations, and staffing difficulties, particularly in developing countries essential to Starbucks' long-term growth. Poor management of these risks could harm the company’s business and financial performance.

As a retailer reliant on consumer spending, Starbucks is vulnerable to economic downturns, job losses, inflation, and shifts toward lower-priced options. Global health crises, like the one in China, can also disrupt operations and reduce customer traffic, with prolonged uncertainty potentially altering consumer behavior and impacting sales.

Based on the data from Figure 3.1, the GDP per capita for the United States increased steadily from 2020 to 2023, reflecting the country's economic recovery post-pandemic. In 2020, the GDP per capita was $64,367.44, and by 2023, it had grown to $81,632.25. Projections from the IMF indicate continued

growth through 2028, with the GDP per capita expected to reach $97,230.61. This trend highlights the robust nature of the U.S. economy compared to global averages, with the U.S. consistently outperforming both advanced and emerging market economies during this period.

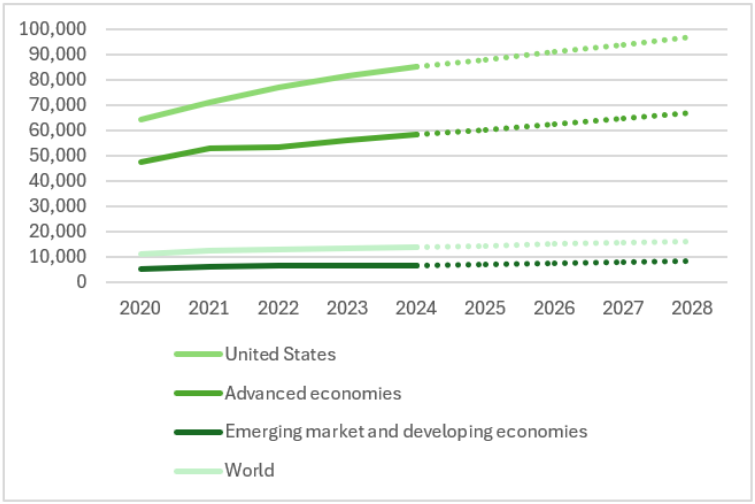

Figure 3.1: **GDP per capita, current prices (U.S. dollars per capita).** Adapted from IMF.

3.2. Industry Outlook

Starbucks Corporation falls under the U.S. Restaurants – Consumer Discretionary sector. It competes in the global fast food and restaurant industry, primarily focusing on the premium coffee and snacks store market.

Since 2020, the Restaurants – Consumer Discretionary sector, including Starbucks Corporation and its competitors, has navigated significant challenges and transformations. The COVID-19 pandemic precipitated widespread disruptions across the industry, resulting in substantial revenue declines and operational adjustments. For Starbucks specifically, global same-store sales plummeted by 9% in 2020, reflecting the impact of reduced foot traffic and store closures (Starbuck, 2020). As vaccination efforts progressed and restrictions eased, the sector began a gradual recovery trajectory. Starbucks reported a 15% increase in global comparable store sales in 2021 compared to the previous year, driven by a rebound in customer visits and strong performance in key markets like China (Starbucks, 2021). However, the road to recovery has been fraught with challenges. Labor shortages and increased operational costs have been prominent issues. Starbucks responded by implementing wage increases, with hourly wages rising by approximately 10% in the U.S. to attract and retain employees amidst a competitive labor market.

Starbucks has been named in 2023 one of the world's most admired companies by Fortune Magazine (Starbucks, 2023). This recognition is a testament to Starbucks' global influence and strong reputation in the coffee industry. The ranking is based on a survey conducted by Fortune, which

evaluates companies on nine criteria: investment value, quality of management, quality of products and services, social responsibility, innovation, people management, use of corporate assets, financial soundness, and global competitiveness. Starbucks stands out for its leadership in innovation and ethical business practices. The company's commitment to sustainability and social responsibility plays a significant role in its esteemed position. Starbucks actively engages in community support, environmental sustainability initiatives, and ethical sourcing of coffee. These efforts resonate well with consumers and the business community alike. The Fortune Magazine highlights Starbucks' consistent quality in customer experience across its global stores as a key factor in its admiration. Despite its vast international presence, the company maintains high standards in its products and services, ensuring a unique and satisfying experience for customers worldwide. Starbucks' ability to attract and retain talent, along with its strategic management and use of corporate assets, further solidifies its place as a leader in the industry.

3.2.1. Competitors

Starbucks faces competition from specialty coffee retailers, quick-service restaurants, and the ready-to-drink coffee market. Customers prioritize product quality, brand reputation, service, convenience, and price when choosing among competitors. Additionally, Starbucks competes for prime retail locations and skilled personnel. Its Channel Development segment faces competition in grocery stores, specialty retailers, convenience stores, and foodservice accounts.

Intense competition in every market threatens Starbucks' profitability. The specialty coffee market is highly competitive in terms of product quality, innovation, service (including delivery and mobile ordering), and price. In the U.S., major quick-service restaurants offering high-quality coffee could reduce Starbucks' customer numbers and transaction values. Globally, competition in packaged coffee, tea, and ready-to-drink beverages could hurt the profitability of its Channel Development segment, especially from competitors with lower environmental or sustainability costs.

Furthermore, failure to meet consumer demand for healthier beverages and foods, while competitors succeed, could harm Starbucks. Changes in consumer preferences, economic conditions, or daily routines could further negatively impact its business.

Although Starbucks holds a strong market position, the company face some competitors who present some challenges through various strategies such as pricing, product quality, and customer experience. The Starbucks’ main competitors are:

- Cava Group, Inc.: Specializing in Mediterranean cuisine, Cava competes with Starbucks by appealing to health-conscious consumers looking for quick meal options, which may include beverages;

- Chipotle Mexican Grill, Inc.: While primarily focused on Mexican cuisine, Chipotle appeals to health-conscious consumers and offers beverages that can indirectly compete with Starbucks' offerings;
- Coca-Cola Co: As a major player in the beverage industry, Coca-Cola competes indirectly with Starbucks through ready-to-drink coffee products and various beverage offerings;
- Darden Restaurants, Inc.: The parent company of Olive Garden and LongHorn Steakhouse, Darden competes by providing dining experiences that include coffee and tea options;
- Domino's Pizza, Inc.: Known primarily for its pizza, Domino's competes with Starbucks by offering a selection of beverages, including coffee, to complement its food menu;
- McDonald's Corporation: Known for its extensive global presence, McDonald's competes with Starbucks through its McCafé brand, offering a wide range of coffee and espresso drinks;
- Restaurant Brands International Inc.: As the parent company of Burger King and Tim Hortons, it competes with Starbucks through Tim Hortons, which is well-known for its coffee and breakfast items;
- Wendy's Co: Wendy's competes with Starbucks by providing coffee options in its menu alongside its fast-food offerings, aiming to attract breakfast customers;
- Yum! Brands, Inc.: As the parent company of popular fast-food chains like Taco Bell and KFC, Yum! Brands compete with Starbucks by providing quick-service dining options that include coffee beverages.

Starbucks faces competition from a diverse array of players, including fast-food giants like McDonald's and Yum! Brands, casual dining establishments like Chipotle and Darden Restaurants, beverage companies like Coca-Cola, and specialty coffee brands, all of which strive to capture market share through their own coffee and beverage offerings.

3.2.2. Competitive Advantage

Starbucks maintains several competitive advantages that reinforce its leadership in the global coffee industry (Starbucks, 2023):

1. Brand Strength and Recognition: Starbucks is a highly respected brand synonymous with premium coffee, exceptional customer service, and community engagement, attracting and retaining customers;
2. Community and Social Impact: Emphasizing corporate social responsibility, Starbucks engages in sustainability and community initiatives, aligning with modern consumer values and enhancing its public image;

3. Customer Loyalty Program: The successful Starbucks Rewards program, integrated with its mobile app, boosts customer retention, encourages higher spending, and collects valuable consumer data for tailored marketing;
4. Global Store Network: With an extensive network of stores, Starbucks offers convenience and enhances brand visibility, outpacing its competitors;
5. Premium Product Mix: By continually innovating its offerings, including seasonal specialties and non-coffee alternatives, Starbucks appeals to a diverse customer base and adapts to changing tastes;
6. Strong Financial Position: Robust financial health allows Starbucks to invest in expansion, technology, and other strategic initiatives that enhance its competitive edge;
7. Supply Chain Control: Significant control over its supply chain—from coffee sourcing to distribution—ensures consistent quality and ethical practices, appealing to socially conscious consumers;
8. Technology Integration: Starbucks leads in technology use, with a highly functional mobile app that facilitates ordering, payment, and personalized marketing.

These advantages have been crucial for Starbucks in sustaining growth and navigating competition in the dynamic global coffee market.

4. Valuation

This chapter incorporates both discounted cash flow analysis and relative valuation methods. DCF provides an intrinsic value based on future cash flow projections, while relative valuation offers insights through comparisons with industry peers. This complementary approach allows for a more comprehensive assessment of Starbucks' market position, growth potential, and overall value, enhancing the robustness of the valuation findings.

4.1. Discounted Cash Flow Valuation

This section focuses on the computation of Starbucks' equity value and share price during the period under analysis, using a DCF model. The process involves projecting future cash flows, estimating the terminal value, and discounting both using the WACC to determine the enterprise value. Adjustments are then made by subtracting debt and adding non-operating assets to compute the final equity value and share price. A sensitivity analysis is subsequently conducted to assess how variations in key assumptions, such as the discount rate and terminal growth rate, impact the equity value and share price estimates.

4.1.1. Assumptions

This chapter outlines the valuation of Starbucks using the DCF method, which involves projecting future cash flows to estimate the company’s equity value. The analysis is based on historical financial data, including income statements, balance sheets, and cash flow statements from 2020 to 2023, providing the groundwork for forecasting. This stage is crucial, as it involves making informed assumptions about Starbucks’ future performance. The key assumptions and details of the financial model will be further explored in the following sections. The historical analysis captures the period impacted by the pandemic, allowing for a comparison between the affected years and the subsequent recovery. A five-year forecast period from 2024 to 2028 is used to provide a comprehensive outlook, utilizing available data and industry trends relevant to Starbucks and the broader coffee market.

4.1.2. Revenue

Several components of an equity valuation vary based on the revenue projection, making it one of the most crucial components.

Starbucks' future revenues were based on estimates of historical revenues of annual reports. A CAGR of 15% was utilized to project the company's sales performance over the forecast period (Table 4.1). This approach captures the consistent growth trend observed in the historical period between 2020 to 2023 and reflects Starbucks’ long-term growth strategy.

Table 4.1: **Historical Revenues.** Starbucks Annual Reports 2020, 2021, 2022, 2023, & own estimates.

in millions ($)	2020	2021	2022	2023	CAGR
Revenues	23,518.00	29,060.60	32,250.30	35,975.60	15.22%

According to Starbucks (2023), Starbucks' financial results and long-term growth model are primarily driven by new store openings, comparable store sales, and margin management. The company has expressed confidence in sustaining its global store growth trajectory in 2024, fueled by a diverse range of store formats in the U.S. and leveraging its strong brand presence internationally. By applying CAGR, the revenue projections incorporate these strategic growth drivers, providing a realistic and robust foundation for the overall valuation and significantly influencing the estimated share price of Starbucks. This strategy is reflected in the forecasted revenue growth, as shown in Table 4.2.

Table 4.2: **Revenues Forecast.** Own estimates.

in millions ($)	2024F	2025F	2026F	2027F	2028F
Revenues	41,451.85	47,761.70	55,032.05	63,409.10	73,061.31

4.1.3. EBIT

To forecast the EBIT an average of the EBIT margin was calculated based on historical data from 2020 to 2023, resulting in an estimated EBIT as a percentage of revenues at 13.51% for the forecasted years (Table 4.3).

Table 4.3: **Historical EBIT.** Starbucks Annual Reports 2020, 2021, 2022, 2023, & own estimates.

in millions ($)	2020	2021	2022	2023	% Average EBIT/ Revenues ratio
Revenues	23,518.00	29,060.60	32,250.30	35,975.60	
EBIT	1,561.70	4,872.10	4,617.80	5,870.80	
EBIT as a % of Revenues	6.64%	16.77%	14.32%	16.32%	13.51%

With this rate established, future EBIT can be projected by applying the formula: EBIT = Revenues X 13.51%. This approach allows for straightforward forecasting of EBIT by scaling it according to projected revenues in the upcoming years (Table 4.4).

Table 4.4: **EBIT Forecast.** Own estimates.

in millions ($)	2024F	2025F	2026F	2027F	2028F
Revenues	41,451.85	47,761.70	55,032.05	63,409.10	73,061.31
EBIT	5,600.48	6,452.99	7,435.27	8,567.08	9,871.17

4.1.4. Depreciation and Amortization

To project Starbucks' depreciation and amortization, a similar methodology was applied as used in the EBIT forecasting process, therefore, the average ratio of the reported period was equal to 4.83% for the given forecast (Table 4.5).

Table 4.5: **Historical Depreciation and Amortization.** Starbucks Annual Reports 2020, 2021, 2022, 2023, & own estimates.

in millions ($)	2020	2021	2022	2023	% Average D&A/ Revenues ratio
Revenues	23,518.00	29,060.60	32,250.30	35,975.60	
Depreciation and Amortization	1,431.30	1,441.70	1,447.90	1,362.60	
D&A as a % of Revenues	6.09%	4.96%	4.49%	3.79%	4.83%

By maintaining consistency in the approach, the estimates for depreciation and amortization were derived, ensuring alignment with the broader financial projections and maintaining the integrity of the overall valuation model.

Table 4.6: **Depreciation and Amortization Forecast.** Own estimates.

in millions ($)	2024F	2025F	2026F	2027F	2028F
Revenues	41,451.85	47,761.70	55,032.05	63,409.10	73,061.31
Depreciation and Amortization	2,002.55	2,307.38	2,658.62	3,063.31	3,529.62

4.1.5. Capital Expenditures

The forecast of capital expenditures for Starbucks was determined as a percentage of projected revenues, reflecting the historical relationship between CapEx and sales observed from 2020 to 2023. This method involved calculating the average CapEx-to-revenue ratio during the historical period, establishing a representative percentage to be applied to the forecast period. The percentage was determined to be 5.89% (Table 4.7).

Table 4.7: **Historical CapEx.** Starbucks Annual Reports 2020, 2021, 2022, 2023, & own estimates.

in millions ($)	2020	2021	2022	2023	% Average CapEx/ Revenues ratio
Revenues	23,518.00	29,060.60	32,250.30	35,975.60	
Additions to property, plant and equipment (CapEx)	1,483.60	1,470.00	1,841.30	2,333.60	
CapEx as a % of revenues	6.31%	5.06%	5.71%	6.49%	5.89%

According to Starbucks (2023), the company's cash requirements for 2024 will primarily consist of capital expenditures related to investments in new and existing stores, supply chain enhancements, and corporate facilities. By aligning the CapEx forecasts with these strategic priorities and historical spending patterns, the projections provide a realistic estimate of Starbucks' future capital investments necessary to support ongoing growth and operational improvements (Table 4.8).

Table 4.8: **CAPEX Forecast.** Starbucks Annual Reports 2020, 2021, 2022, 2023, & own estimates.

in millions ($)	2024F	2025F	2026F	2027F	2028F
Revenues	41,451.85	47,761.70	55,032.05	63,409.10	73,061.31
Additions to property, plant and equipment (CapEx)	2,441.80	2,813.50	3,241.77	3,735.24	4,303.82

4.1.6. Working Capital

The working capital of Starbucks was computed based on the difference between its operating current assets and liabilities, as shown in Table 4.9.

Table 4.9: **Working Capital.** Starbucks Annual Reports 2020, 2021, 2022, 2023, & own estimates

in millions ($)	2020	2021	2022	2023
(+) Accounts receivable, net	883.40	940.00	1,175.50	1,184.10
(+) Inventories	1,551.40	1,603.90	2,176.60	1,806.40
(+) Prepaid expenses and other current assets	739.50	594.60	483.70	359.90
(-) Accounts payable	997.90	1,211.60	1,441.40	1,544.30
(-) Accrued liabilities	1,258.90	2,321.20	2,137.10	2,145.10
(-) Accrued payroll and benefits	696.00	772.30	761.70	828.30
(-) Current portion of operating lease liability	1,248.80	1,251.30	1,245.70	1,275.30
(-) Stored value card liability and current portion of deferred revenue	1,456.50	1,596.10	1,641.90	1,700.20
(=) Working Capital	-2,483.80	-4,014.00	-3,392.00	-4,142.80

The forecasted working capital, expressed as a percentage of revenues, remains negative, averaging -11.60% from 2024 to 2028 (Table 4.10). This indicates that Starbucks efficiently manages its operations by using its current liabilities to finance short-term needs, minimizing cash tied up in inventory and receivables. The negative working capital reflects Starbucks' strong cash flow and quick inventory turnover, as the company sells products directly to consumers and receives cash immediately while taking longer to pay its suppliers. This allows Starbucks to support its operations and invest in growth without relying heavily on external financing, helping the company maintain liquidity and optimize cash flow, thereby enhancing its capacity to invest in new store openings and upgrades to existing locations.

Table 4.10: **Historical Working Capital.** Starbucks Annual Reports 2020, 2021, 2022, 2023, & own estimates.

in millions ($)	2020	2021	2022	2023	% Average D&A/ Revenues ratio
Revenues	23,518.00	29,060.60	32,250.30	35,975.60	
Working Capital	-2,483.80	-4,014.00	-3,392.00	-4,142.80	
WC as a % of Revenues	-10.56%	-13.81%	-10.52%	-11.52%	-11.60%

The detailed forecast values for working capital are computed in Table 4.11.

Table 4.11: **Working Capital Forecast.** Own estimates.

in millions ($)	2024F	2025F	2026F	2027F	2028F
Revenues	41,451.85	47,761.70	55,032.05	63,409.10	73,061.31
Working Capital	-4,809.15	-5,541.21	-6,384.70	-7,356.58	-8,476.41

4.1.7. Free Cash Flow to the Firm

For the valuation of Starbucks, a forecast corporate tax rate of 25% was applied consistently throughout the projection period. This rate reflects an assumption that balances current legislative proposals and potential changes in the corporate tax landscape in the U.S. over the coming years.

With all key assumptions and projections established, it is now possible to calculate the Free Cash Flow to the Firm for the forecast period from 2024 to 2028. This step is crucial in the Discounted Cash Flow model as it enables us to determine the intrinsic value of Starbucks by assessing the cash flows available to the company after accounting for operational costs and investments.

For Starbucks, the historical data from 2020 to 2023 and forecasted figures through 2028 reveal a generally positive trend in operating cash flows, indicating strong cash generation capabilities (Table 4.12). Although CapEx has increased, reflecting has investment in growth and expansion, the overall FCFF demonstrates an upward trajectory, highlighting the company's potential for value creation.

Table 4.12: **Free Cash Flow to the Firm Forecast.** Own estimates.

in millions ($)	2024F	2025F	2026F	2027F	2028F
EBIT	5,600.48	6,452.99	7,435.27	8,567.08	9,871.17
(-) Taxes	1,400.12	1,613.25	1,858.82	2,141.77	2,467.79
(=) NOPLAT	4,200.36	4,839.74	5,576.46	6,425.31	7,403.38
(+) Depreciation and amortization	2,002.55	2,307.38	2,658.62	3,063.31	3,529.62
(=) Operating Cash Flow	6,202.91	7,147.13	8,235.07	9,488.62	10,932.99
(-) CapEx net of disposals	2,441.80	2,813.50	3,241.77	3,735.24	4,303.82
(-) Changes in WC	-666.35	-732.06	-843.49	-971.89	-1,119.83
(=) FCFF	4,427.46	5,065.69	5,836.79	6,725.27	7,749.00

4.1.8. Weighted Average Cost of Capital

In the context of the FCFF analysis, the WACC plays a critical role as the discount rate used to calculate the present value of future cash flows. Starbucks' WACC represents the blended cost of its equity and debt financing, adjusted for their respective proportions in the company’s capital structure.

4.1.8.1. Capital Structure

To analyze Starbucks' capital structure, the market value of equity was determined by multiplying the share price at the end of the most recent trading day by the total number of shares outstanding for the corresponding year. This calculation provides an estimate of the company's equity value as perceived by the market. The market value of debt was obtained from Starbucks’ annual report from 2020 to 2023 (Starbucks, 2020, 2021, 2022, 2023), which details the value of outstanding debt as recorded in the financial statements. Combining these values allows for an assessment of the proportion of equity and debt in Starbucks' capital structure. As a result, the debt-to-equity ratio in 2023 was calculated to be 0.12 (Table 4.13).

Table 4.13: **Capital Structure.** Starbucks Annual Reports 2020, 2021, 2022, 2023, & own estimates.

in millions ($)	2020	2021	2022	2023
# shares outstanding	1,184.60	1,173.30	1,180.00	1,147.90
Share price (in the end of the year)	106.98	116.97	99.20	96.01
Market value of Equity	126,728.51	137,240.90	117,056.00	110,209.88
Market value of Debt	17,500.00	16,014.00	13,052.00	13,426.00
D/E Ratio	0.14	0.12	0.11	0.12

4.1.8.2. Cost of Debt

To determine the discount rate for Starbucks, it is essential to calculate the cost of debt. This is typically derived from the yield to maturity (YTM) of a relevant debt instrument. For this analysis, the cost of debt was determined using the yield to maturity of a 10-year Starbucks bond, which stands at 4.57%. This yield represents the annual return investors expect if they hold the bond until maturity, effectively reflecting Starbucks' borrowing costs. Understanding this cost of debt ensures that our DCF analysis reflects the true cost of capital for the company.

4.1.8.3. Cost of Equity

The cost of equity for Starbucks was determined using the CAPM, which relies on three main factors: the risk-free rate, the market risk premium, and the company's levered beta. These components are essential in estimating the return investors expect, factoring in both market-level risks and Starbucks' specific volatility. The following sections will break down each of these elements and explain how they influence the calculation of Starbucks' cost of equity.

Risk-free rate

The risk-free rate was determined using the yield on the U.S. 10-year Treasury Bond as of December 29, 2023. This bond is classified as AAA, according to Moody's, reflecting its high credit quality and minimal default risk, making it a reliable benchmark for a risk-free investment. On December 29, 2023, the yield on this Treasury Bond was 3.87%. This rate is pivotal in calculating Starbucks' cost of equity, as it represents the baseline return on a virtually risk-free asset. By using this AAA-rated Treasury yield, the analysis provides a robust foundation for determining the equity risk premium and accurately assessing Starbucks' overall cost of capital.

Market Risk Premium

The Market Risk Premium represents the additional return that investors require for investing in a risky market portfolio as opposed to a risk-free asset. To estimate the MRP, one typically follows a two-step process. First, assess the credit rating of the underlying market, with the US holding a AAA rating

according to Moody's. This rating indicates a low risk of default. Next, add the default spread associated with this rating to the market risk premium of a mature market. Aswath Damodaran, a prominent finance professor at NYU Stern Business School, has estimated the MRP for the US market to be 4.60%[1]. This estimate reflects the extra return investors demand for taking on market risk, in line with the methodology described.

Levered Beta

The final step in determining the cost of equity for Starbucks is calculating the levered beta, which measures the company's exposure to overall market risk while accounting for its capital structure (debt and equity). Since Starbucks is a publicly traded company, its levered beta can be sourced from financial platforms such as Yahoo Finance. The levered beta considered in the valuation was 0.96, retrieved from Yahoo Finance. This value indicates that Starbucks' stock is slightly less volatile than the overall market, where a beta of 1 represents market-level risk. The levered beta is a key input in the CAPM, which is used to calculate the cost of equity by adjusting for both company-specific and market risks.

Cost of Equity

The cost of equity represents the return required by investors for taking on the risk of investing in a company's equity. For Starbucks, the cost of equity was calculated using the CAPM, as expressed in equation (6). The inputs included a risk-free rate of 3.87% (based on the US 10-year Treasury Bond), a levered beta of 0.96, and a market risk premium of 4.60%. Using these values, Starbucks' cost of equity was computed to be 8.28%. This value reflects the return investors expect from holding Starbucks' stock, compensating them for both the time value of money and market risk.

4.1.8.4. WACC

To compute the WACC, key inputs include the cost of equity (8.28%) which was derived using the CAPM, and the cost of debt (4.57%), which was based on the yield to maturity of Starbucks' 10-year bonds. Additionally, the company's debt-to-equity ratio of 0.12 was factored in, along with a corporate tax rate to account for the tax shield on debt. Based on equation (5) the final WACC for Starbucks was calculated to be 7.76%. This rate is crucial for discounting future free cash flows in the FCFF model, allowing for the estimation of the firm's intrinsic value.

[1] https://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/ctryprem.html

4.1.9. Terminal Value

The terminal value in a DCF-FCFF analysis represents the value of Starbucks' future cash flows beyond the forecast period, assuming they continue indefinitely. The terminal value was calculated using a perpetual growth rate of 2.10%, which reflects the long-term sustainable growth of the company. This growth rate is consistent with broader economic forecasts and aligns with estimates from the International Monetary Fund (IMF) for real GDP growth in mature markets like the United States. By using this growth assumption, the terminal value captures the expected long-term expansion of Starbucks' operations, while ensuring the estimate remains conservative and in line with macroeconomic trends. The terminal value contributes significantly to the total enterprise value of Starbucks, as it reflects the firm's ongoing ability to generate cash flow beyond the explicit forecast period, as can be observed in Table 4.14. As mentioned earlier and as per equation (4), the FCFF for the year following the forecast period ($FCFF_{n+1}$) is $7,911.73 million, leading to a terminal value of $139,750.72 million.

4.1.10. Enterprise Value

The Enterprise Value represents the present value of all the future cash flows a company is expected to generate. These cash flows are divided into two parts: the short-term estimated cash flows, based on the company's forecasted growth over a defined period, and the terminal value, which reflects the present value of all cash flows expected to be generated beyond this forecast horizon, in perpetuity. Together, these two components provide a comprehensive measure of the company's total operational worth (Table 4.14).

Table 4.14: **Enterprise Value.** Starbucks Annual Reports 2020, 2021, 2022, 2023, & own estimates.

in millions ($)	2023	2024F	2025F	2026F	2027F	2028F
FCFF		4,427.46	5,065.69	5,836.79	6,725.27	7,749.00
PV of FCFF		4,108.58	4,362.27	4,664.29	4,987.22	5,332.51
Terminal Value						139,750.72
PV of Terminal Value						96,169.99
EV	119,624.86					

4.1.11. Equity Value

The equity value of Starbucks, calculated to be $106,595.76 million, reflects the value of the company's shares available to its shareholders. To determine this value, the enterprise value of $119,624.86 million was adjusted for non-operating assets and debt.

Non-operating assets, sourced from Starbucks' 2023 balance sheet, include cash and cash equivalents, short-term investments, long-term investments, equity investments, deferred income taxes, net, other long-term assets, other intangible assets and goodwill, totaled $10,295.40 million as

of 2023 (Table 4.15). These assets are not directly tied to Starbucks' core business operations but contribute to the overall value of the company.

Table 4.15: **Non-operating assets.** Starbucks Annual Report 2023.

in millions ($)	2023
Cash and cash equivalents	3,551.50
Short-term investments	401.50
Long-term investments	247.40
Equity investments	439.90
Deferred income taxes, net	1,769.80
Other long-term assets	546.50
Other intangible assets	120.50
Goodwill	3,218.30
Total Non-Operating Assets	10,295.40

Conversely, the company's total debt, also derived from the 2023 balance sheet, includes short-term debt, current portion of long-term debt, long-term debt, and operating lease liabilities, amounted to $23,324.50 million (Table 4.16).

Table 4.16: **Debt.** Starbucks Annual Report 2023.

in millions ($)	2023
Short-term debt	33.50
Current portion of long-term	1,818.60
Long-term debt	13,547.60
Operating lease liability	7,924.80
Total Debt	23,324.50

By subtracting the total debt from the sum of the enterprise value and non-operating assets, the equity value is determined. This calculation provides a clearer picture of the net worth attributable to Starbucks' shareholders, reflecting the value of the company's equity after accounting for its financial obligations and non-core assets.

4.1.12. Share Price

With the equity value computed, the DCF-FCFF analysis is concluded, and the next step is to find the target price for Starbucks' shares. This is done by dividing the equity value of $106,595.76 million by the total number of outstanding shares, which stood at $1,147.90 million at the end of 2023. This calculation results in a share fair value of $92.86 as of December 2023. In contrast, the actual market closing price of Starbucks' stock on that date was $96.01. The slightly higher market share price

indicates that, according to the DCF valuation, Starbucks' shares were potentially overvalued at the time.

4.1.13. Sensitivity Analysis

To enhance the DCF approach, a sensitivity analysis was conducted focusing on two crucial factors: the perpetuity growth rate and the discount rate (WACC). This analysis allows for an examination of how variations in these inputs affect the share price under different conditions. By altering each factor by ±0.25%, the analysis provides a range of possible outcomes, reflecting the inherent uncertainties in growth projections and discount rate estimates. As illustrated in Table 4.17, these adjustments reveal the potential impact on the valuation.

In Table 4.17, areas marked in green indicate scenarios where the share price exceeds the base valuation of $92.86, suggesting a potential increase in value. Conversely, areas marked in red highlight scenarios where the share price drops, signaling a decrease in value. The grey area represent the original valuation value based on the current WACC and growth rate.

Table 4.17: **Sensitivity Analysis.** Own estimates.

		WACC				
		7.26%	7.51%	7.76%	8.01%	8.26%
g	1.60%	94.71	90.01	85.69	81.70	78.02
	1.85%	98.87	93.78	89.12	84.84	80.90
	2.10%	103.44	97.91	**92.86**	88.25	84.01
	2.35%	108.47	102.43	96.95	91.95	87.38
	2.60%	114.04	107.41	101.43	96.00	91.05

The sensitivity analysis shows us that the share price of Starbucks could vary between a low of $78.02 and a high of $114.04, reflecting a potential decrease of 15.98% and an increase of 22.80% compared to the initial DCF valuation.

4.2. Relative Valuation

As discussed earlier, the multiples approach serves as a valuable secondary method for validating and reinforcing the results of the DCF analysis. By comparing Starbucks to similar companies in the industry, this approach helps to ensure that the DCF valuation is realistic and well-supported. The first step in this process was to identify a peer group of comparable companies within the restaurant sector, selected based on factors like product offerings, market positioning, and performance. According to Table 4.18, a peer group of 9 companies from the restaurant industry was selected.

The P/E ratio and the EV/EBITDA multiple were chosen as the key metrics, given their widespread use in relative valuations. The data for these multiples was sourced from FinanceCharts and YCharts, from the end of 2023.

To ensure a reliable dataset, outliers were removed using a standard deviation method. Companies with multiples falling above or below one standard deviation from the group average were excluded. As a result, one company was excluded from both the P/E and EV/EBITDA calculations. Following this adjustment, the average P/E ratio was 26.59x, and the average EV/EBITDA multiple was 19.12x.

***Table 4.18:* P/E and EV/EBITDA Multiples.** Own estimates & FinanceCharts & YCharts.

Peer Group	Country	P/E	EV/EBITDA
McDonald's Corporation	US	25.63	17.71
Yum! Brands, Inc.	US	23.37	19.45
Chipotle Mexican Grill, Inc.	US	51.36	32.37
Restaurant Brands International Inc.	Canadian	20.72	18.99
Wendy's Co	US	19.88	12.77
Coca-cola Co	US	23.76	19.40
Cava Group, Inc.	US	158.73	64.83
Darden Restaurants, Inc.	US	19.87	12.53
Domino's Pizza, Inc.	US	28.12	19.77
Average		41.27	24.20
Standard Deviation		45.11	16.27
Average + Standard Deviation		86.38	40.48
Average - Standard Deviation		-3.84	7.93
Average excluding outliers		26.59	19.12

With these multiples established, the relative valuation of Starbucks could then be conducted and is presented in Table 4.19.

***Table 4.19:* Relative Valuation.** Own estimates.

in millions ($)	P/E Valuation	EV/EBITDA Valuation
Peer group Multiple	26.59x	19.12x
Starbucks Corporation: Net income	4,124.50	-
Starbucks Corporation: EBITDA	-	7,233.40
Enterprise Value	-	138,329.73
Equity Value	109,665.30	125,300.63
# Shares outstanding	1,147.90	1,147.90
Starbucks share price	95.54	109.16

The results of the relative valuation using the P/E and EV/EBITDA multiples provide valuable insights into Starbucks' stock valuation. The P/E ratio yielded a share price of $95.54, which is higher than the DCF valuation of $92.86 but lower than the market price of $96.01 at the end of 2023. This suggests that, based on the earnings performance relative to its peers, Starbucks' stock may have been

slightly overvalued by the market. On the other hand, the EV/EBITDA multiple produced a share price of $109.16, which is significantly higher than the market price, indicating that when considering the stock may appear undervalued relative to its intrinsic value. These results from the Relative Valuation approach highlight that while Starbucks' market price aligns closely with its intrinsic value according to the P/E ratio, it suggests a different valuation perspective when assessed through the EV/EBITDA metric.

Conclusion

This report aimed to estimate the share intrinsic value of Starbucks at the end of 2023, with the goal of assessing whether the stock was being traded at its fair value. To achieve this, the actual market price was compared to the estimated value derived from financial models. The valuation process employed two complementary methodologies to ensure a more robust estimation.

The primary method used was the DCF approach, specifically focusing on the Free Cash Flow to the Firm to determine Starbucks' equity value. Following this, a secondary stage of analysis was conducted using a Relative Valuation approach, comparing Starbucks to a group of similar companies. This step was essential in validating and enhancing the conclusions drawn from the DCF model.

In conclusion, the Equity Valuation of Starbucks, based on both the DCF-FCFF and Relative Valuation methods, suggests that the company's stock was generally fairly valued at the end of 2023. The DCF-FCFF approach estimated a share price of $92.86, closely matching the actual market price of $96.01, indicating that Starbucks' shares were slightly overvalued. In contrast, the Relative Valuation yielded different outcomes: the Price-to-Earnings ratio suggested a value of $95.54, while the EV/EBITDA multiple indicated a higher valuation of $109.16.

Despite these variations, both methods produced comparable results, enhancing confidence in the overall valuation and suggesting that the shares were generally aligned with their intrinsic value, albeit with minor fluctuations based on the valuation approach used. This comprehensive analysis provides a well-supported estimation of the company's stock value at the end of 2023.

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Appendix

Income statement in millions, except per share data ($)	2020	2021	2022	2023
Net Revenues:				
Company-operated stores	19 164,6	24 607,0	26 576,1	29 462,3
Licensed stores	2 327,1	2 683,6	3 655,5	4 512,7
Other	2 026,3	1 770,0	2 018,7	2 000,6
Total net revenues	23 518,0	29 060,6	32 250,3	35 975,6
Product and distribuition costs	7 694,9	8 738,7	10 317,4	11 409,1
Store operating expenses	10 764,0	11 930,9	13 561,8	14 720,3
Other operating expenses	430,3	359,5	461,5	539,4
Depreciation and amortization expenses	1 431,3	1 441,7	1 447,9	1 362,6
General and administrative expenses	1 679,6	1 932,6	2 032,0	2 441,3
Restructuring and impairments	278,7	170,4	46,0	21,8
Total operating expenses	22 278,8	24 573,8	27 866,6	30 494,5
Income from equity investees	322,5	385,3	234,1	298,4
Gain from sale of assets	-	-	-	91,3
Operating income	1 561,7	4 872,1	4 617,8	5 870,8
Net gain resulting from divestiture of certain operations	-	864,5	-	-
Interest income and other, net	39,7	90,1	97,0	81,2
Interest expense	-437,0	-469,8	-482,9	-550,1
Earnings before income taxes (EBT)	1 164,4	5 356,9	4 231,9	5 401,9
Income tax expense	239,7	1 156,6	948,5	1 277,2
Net earnings including noncontrolling interests	924,7	4 200,3	3 283,4	4 124,7
Net earnings/(loss) attributable to noncontrolling interest	-3,6	1,0	1,8	0,2
Net earnings attributable to Starbucks	928,3	4 199,3	3 281,6	4 124,5
Earnings per share - basic	0,79	3,57	2,85	3,60
Earnings per share - diluted	0,79	3,54	2,83	3,58
Weighted average shares outstanding:				
Basic	1 172,8	1 177,6	1 153,3	1 146,8
Diluted	1 181,8	1 185,5	1 158,5	1 151,3

Appendix A: **Historical Income Statement**. Starbucks Annual Reports 2020, 2021, 2022, 2023

Consolidated statements of comprehensive income in millions ($)	2020	2021	2022	2023
Net earnings including noncontrolling interests	924,7	4 200,3	3 283,4	4 124,7
Other comprehensive income/(loss), net of tax:				
Unrealized holding gains/(losses) on available-for-sale securities	8,3	-3,4	-22,8	3,3
Tax (expense)/benefit	-1,8	0,7	5,6	-0,8
Unrealized gains/(losses) on cash flow hedging instruments	-126,3	283,8	259,5	-149,4
Tax (expense)/benefit	31,3	-43,6	-59,8	17,2
Unrealized gains/(losses) on net investment hedging instruments	38,7	63,1	229,0	73,2
Tax (expense)/benefit	-9,8	-16,0	57,9	-18,5
Translation adjustment and other	206,9	188,2	-794,7	-109,0
Tax (expense)/benefit	1,5	2,2	-	1,8
earnings for available-for-sake securities, hedging instruments,	-20,1	41,8	-210,5	-158,9
Tax expense/(benefit)	5,2	-5,0	34,2	26,1
Other comprehensive income/(loss)	133,9	511,8	-610,4	-315,0
Comprehensive income including noncontrolling interests	1 058,6	4 712,1	2 673,0	3 809,7
Comprehensive income/(loss) attributable to noncontrolling interests	-3,6	1,0	1,8	-0,5
Comprehensive income attributable to Starbucks	1 062,2	4 711,1	2 671,2	3 810,2

Appendix B: **Historical statements of comprehensive income.** Starbucks Annual Reports 2020, 2021, 2022, 2023

Balance sheet in millions ($)	2020	2021	2022	2023
Assets				
Current Assets:				
Cash and cash equivalents	4 350,9	6 455,7	2 818,4	3 551,5
Short-term investments	281,2	162,2	364,5	401,5
Accounts receivable, net	883,4	940,0	1 175,5	1 184,1
Inventories	1 551,4	1 603,9	2 176,6	1 806,4
Prepaid expenses and other current assets	739,5	594,6	483,7	359,9
Total current assets	7 806,4	9 756,4	7 018,7	7 303,4
Long-term invesments	206,1	281,7	279,1	247,4
Equity investments	478,7	268,5	311,2	439,9
Property, plant and equipment, net	6 241,4	6 369,5	6 560,5	7 387,1
Operating lease, right-of-use asset	8 134,1	8 236,0	8 015,6	8 412,6
Deferred income taxes, net	1 789,9	1 874,8	1 799,7	1 769,8
Other long-term assets	568,6	578,5	554,2	546,5
Other intangible assets	552,1	349,9	155,9	120,5
Goodwill	3 597,2	3 677,3	3 283,5	3 218,3
Total assets	29 374,5	31 392,6	27 978,4	29 445,5
Liabilities and shareholders' equity/(deficit)				
Current liabilities:				
Accounts payable	997,9	1 211,6	1 441,4	1 544,3
Accrued liabilities	1 258,9	2 321,2	2 137,1	2 145,1
Accrued payroll and benefits	696,0	772,3	761,7	828,3
Current portion of operating lease liability	1 248,8	1 251,3	1 245,7	1 275,3
Stored value card liability and current portion of deferred revenue	1 456,5	1 596,1	1 641,9	1 700,2
Short-term debt	438,8	-	175,0	33,5
Current portion of long-term debt	1 249,9	998,9	1 749,0	1 818,6
Total current liabilities	7 346,8	8 151,4	9 151,8	9 345,3
Long-term debt	14 659,6	13 616,9	13 119,9	13 547,6
Operating lease liability	7 661,7	7 738,0	7 515,2	7 924,8
Deferred revenues	6 598,5	6 463,0	6 279,7	6 101,8
Other long-term liabilities	907,3	737,8	610,5	513,8
Total liabilities	37 173,9	36 707,1	36 677,1	37 433,3
Shareholders' deficit:				
Common stock ($0.001 par value) - authorized, 2,400.0 shares; issued and outstanding, 1,142.6 and 1,147.9 shares, respectively	1,2	1,2	1,1	1,1
Additional paid-in capital	373,9	846,1	205,3	38,1
Retained deficit	-7 815,6	-6 315,7	-8 449,8	-7 255,8
Accumulated other comprehensive income/(loss)	-364,6	147,2	463,2	-778,2
Total shareholders' deficit	-7 805,1	-5 321,2	8 706,6	7 994,8
Noncontrolling interests	5,7	6,7	7,9	7,0
Total deficit	-7 799,4	5 314,5	8 698,7	-7 987,8
Total liabilities and shareholders' equity/(deficit)	29 374,5	31 392,6	27 978,4	29 445,5

Appendix C: **Historical balance sheet.** Starbucks Annual Reports 2020, 2021, 2022, 2023

Consolidated statement of cash flows in millions ($)	2020	2021	2022	2023
Operating Activities:				
Net earnings including noncontrolling interests	924,7	4 200,3	3 283,4	4 124,7
Adjustments to reconcile net earnings to net cash provided by operating activities:				
Depreciation and amortization	1 503,2	1 524,1	1 529,4	1 450,3
Deferred income taxes, net	-25,8	-146,2	-37,8	-59,4
Income earned from equity method investees	-280,7	-347,3	-268,7	-301,8
Distributions received from equity method investees	227,7	336,0	231,2	222,8
Gain on sale of assets	-	-	-	-91,3
Net gain resulting from divestiture of certain operations	-	-864,5	-	-
Stock-based compensation	248,6	319,1	271,5	302,7
Non-cash lease costs	1 197,6	1 248,6	1 497,7	1 365,9
Loss on retirement and impairment of assets	454,4	226,2	91,4	101,4
Other	24,5	-6,0	-67,8	26,8
Cash provided by/(used in) changes in operating assets and liabilities:				
Accounts receivable	-2,7	-43,0	-326,1	-4,1
Inventories	-10,9	-49,8	-641,0	366,4
Income taxes payable	-1 214,6	286,1	-149,6	52,5
Accounts payable	-210,8	189,9	345,5	100,1
Deferred revenue	31,0	-6,1	-75,8	-110,8
Operating lease liability	-1 231,4	-1 488,1	-1 625,6	1 443,8
Other operating assets and liabilities	-37,0	609,8	339,6	-93,7
Net cash provided by operating activities	1 597,8	5 989,1	4 397,3	6 008,7
Investing activities:				
Purchases of investments	-443,9	-432,0	-377,9	-610,5
Sales of investments	186,7	143,2	72,6	2,5
Maturities and calls of investments	73,7	345,5	67,3	616,9
Additions to property, plant and equipment	-1 483,6	-1 470,0	-1 841,3	-2 333,6
Proceeds from sale of assets	-	-	-	110,0
Net proceeds from the divestiture of certain operations	-	1 175,0	59,3	-
Other	-44,4	-81,2	-126,3	-56,1
Net cash used in investing activities	-1 711,5	-319,5	-2 146,3	-2 270,8
Financing activities:				
Net (payments)/proceeds from issurance of commercial paper	-	-296,5	175,0	-175,0
Net proceeds from issuance of short-term debt	1 406,6	215,1	36,6	114,6
Repayments of short-term debt	-967,7	-349,8	-36,6	-78,8
Net proceed from issuance of long-term debt	4 727,6	-	1 498,1	1 497,8
Repayments of long-term debt	-	-1 250,0	-1 000,0	-1 000,0
Proceeds from issuance of common stock	298,8	246,2	101,6	167,4
Cash dividends paid	-1 923,5	-2 119,0	-2 263,3	-2 431,8
Repurchase of common stock	-1 698,9	-	-4 013,0	-984,4
Minimum tax withholdings on share-based awards	-91,9	-97,0	-127,2	-89,3
Other	-37,7	-	-9,2	-11,1
Net cash provided by/ (used in) financing activities	1 713,3	-3 651,0	-5 638,0	-2 990,6
Effect of exchange rate changes on cash and cash equivalents	64,7	86,2	-250,3	-14,2
Net increase/(decrease) in cash and cash equivalents	1 664,3	2 104,8	-3 637,3	733,1
Cash and cash equivalents:				
Beginning of period	2 686,6	4 350,9	6 455,7	2 818,4
End of period	4 350,9	6 455,7	2 818,4	3 551,5
Supplemental disclosure of cash flow information:				
Cash paid during the period for:				
Interest, net of capitalized interest	396,9	501,1	474,7	524,3
Income taxes	1 699,1	756,3	1 157,6	1 294,2

Appendix D: **Historical statement of cash flows.** Starbucks Annual Reports 2020, 2021, 2022, 2023

in millions ($)	2020	2021	2022	2023
Company-operated stores	19 164,60	24 607,00	26 576,10	29 462,30
Licensed stores	2 327,10	2 683,60	3 655,50	4 512,70
Other	2 026,30	1 770,00	2 018,70	2 000,60
Total net revenues	23 518,00	29 060,60	32 250,30	35 975,60

Appendix E: **Consolidated results of operations.** Starbucks Annual Reports 2020, 2021, 2022, 2023

in millions ($)	2020	2021	2022	2023
Product and distribution costs	7 694,90	8 738,70	10 317,40	11 409,10
Store operating expenses	10 764,00	11 930,90	13 561,80	14 720,30
Other operating expenses	430,30	359,50	461,50	539,40
Depreciation and amortization expenses	1 431,30	1 441,70	1 447,90	1 362,60
General and administrative expenses	1 679,60	1 932,60	2 032,00	2 441,30
Restructuring and impairments	278,70	170,40	46,00	21,80
Total operating expenses	22 278,80	24 573,80	27 866,60	30 494,50

Appendix F: Operating expenses. Starbucks Annual Reports 2020, 2021, 2022, 2023.