

STARBUCKS CORPORATION

U.S. RESTAURANTS – CONSUMER DISCRETIONARY

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COMPANY REPORT

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Store Growth at Scale Continues

Upside potential with food mix and digitalization

- We recommend **buying Starbucks Corporation** given our FY18 price target of USD 69.16 per share, corresponding to an overall upside potential of 22.1% compared to current price levels.
- Strong top-line and organic growth** is guaranteed by increasing beverage innovation, new food lines, as well as mobile order and pay penetration. We believe that Starbucks' initiative of adding higher quality fresh food with the soon to be launched Mercato line will increase average ticket size. Channel Development is the key driver in maintaining operating margins.
- Being a premium brand helps Starbucks to maintain a **strong pricing power**. Our analysis has shown that demand is relatively inelastic on Starbucks' premium. However, the introduction of McDonald's lower priced coffees in January 2018 could become a potential danger for Starbucks.
- Asia Pacific** region offers strong growth opportunities in the future, where we expect a top-line growth at a compound annual growth rate of 26% until 2022.
- Shift from company-operated to licensed stores** in EMEA region will drive operating margins until 2022, which we expect to reach a level of 26.64% in comparison to 11.45% in 2017.

Company description

Starbucks Corporation, founded in 1971 and headquartered in Seattle, is a globally operating premier roaster, marketer and retailer of speciality coffee. With a presence in more than 75 countries, the company is operating through four segments, such as the Americas, CAP (China/ Asia Pacific), EMEA (Europe, Middle East, and Africa) and Channel Development.

Recommendation: BUY

Vs Previous Recommendation HOLD

Price Target FY18: 69.16 €**Price (as of 2-Jan-18)** 57.63 €

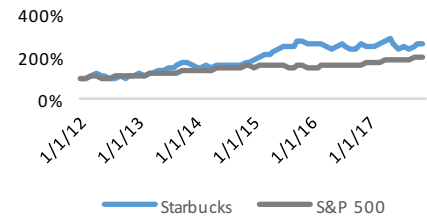
Bloomberg: SBUX US EQUITY

52-week range (USD) 52.58 - 64.87

Market Cap (USD mn) 81,950

Outstanding Shares (mn) 1,422

Source: Bloomberg



Source: Bloomberg

(Values in USD millions)	2018E	2019E	2020E
Revenues	24,403	26,770	29,559
EBITDA	5,706	6,295	6,989
Net Profit	3,122	3,265	3,662
EPS	2.20	2.36	2.64
P/E	31.50	29.34	26.15
EV/Sales	4.2	3.9	3.5
EV/EBITDA	18.0	16.4	14.7
EV/EBIT	23.9	20.7	18.5
ROIC	39.1%	43.3%	45.5%
CAPEX as addition to PPE	1,656	1,817	2,006
FCF	2,605	2,887	3,322

Source: Company Data and Analyst Estimation

THIS REPORT WAS PREPARED EXCLUSIVELY FOR ACADEMIC PURPOSES BY NICHOLAS MAYER, A MASTERS IN FINANCE STUDENT OF THE NOVA SCHOOL OF BUSINESS AND ECONOMICS. THE REPORT WAS SUPERVISED BY A NOVA SBE FACULTY MEMBER, ACTING IN A PURE ACADEMIC CAPACITY, WHO REVIEWED THE VALUATION METHODOLOGY AND THE FINANCIAL MODEL.
(PLEASE REFER TO THE DISCLOSURES AND DISCLAIMERS AT END OF THE DOCUMENT)

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Company overview

Company description

Starbucks Corporation, founded in 1971 and headquartered in Seattle, is a globally operating premier roaster, marketer and retailer of speciality coffee. As of 2017, the company is operating through 27,339 stores in more than 75 countries (Figure 1). Starbucks Corporation is operating in three geographic regions: The Americas, which is inclusive of the United States, Canada as well as Latin America; China/ Asia Pacific (CAP) as well Europe, Middle-East and Africa (EMEA). In the respective regions, Starbucks’ business model is based on three distinct pillars, such as company-operated stores, licensed stores and Channel Development. As of 2017, the Americas region represents 70% of total revenues (Figure 2).

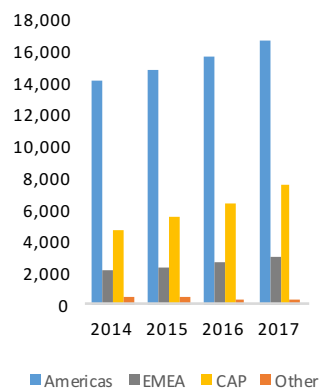


Figure 1: Historical Store Evolution
Source: Company Data

On the one hand, the company is operating and selling its products through company-operated stores, as well as licensed stores. The company purchases coffees which it sells, together with handcrafted coffee, tea and other beverages and a variety of fresh food items, such as different snack offerings and fresh food. In 2017, total revenues were USD 22.3 bn. As Figure 3 depicts, sales in company-operated as well as licensed stores were mainly driven by beverages (73%) as well as food (19%). Starbucks Corporation is forecasted to continuously increase its store roll-out, expecting to reach a store count of 39,550 by 2022. In comparison to the steady low single-digit growth rates in the Americas region, which represents 60% of the total number of operating stores worldwide, Starbucks aggressively expands in the CAP region, where the company plans to more than double its presence, reaching a store count of 15,635 by 2022.

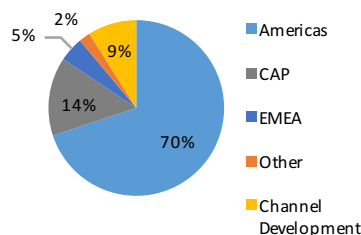


Figure 2: Revenue Split per Segment as of FY 2017
Source: Company Data

On the other hand, the company’s Channel Development segment covers a variety of ready-to-drink products sold worldwide through grocery stores, warehouse clubs, speciality retailers, convenience stores, as well as U.S. foodservice accounts. Especially the Channel Development segment increasingly contributes to Starbucks’ overall performance and is also the most profitable segment among the three operating pillars, showing an operating margin of 44.5% in 2017. In addition to its Starbucks Coffee brand, the company sells goods and services under various brands, as there are Teavana, Tazo, Seattle’s Best Coffee, Evolution Fresh, La Boulange and Ethos. Starbucks’ joint venture with Pepsi-Cola Company, called North American Coffee Partnership, enables the company to benefit from Pepsi-Colas Company’s network in manufacturing and distributing ready-to-drink products.

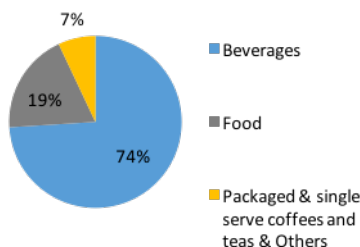


Figure 3: Revenue Mix as of FY 2017
Source: Company Data

Shareholder structure

Starbucks Corporation first went public during its Initial Public Offering in June 1992. Today the company’s shareholder structure is dispersed, where especially American institutional investors, such as the Vanguard Group (6.71%) as well as BlackRock (6.16%) are the players with the biggest stake in the company. In addition to that, the founder and former chief executive officer (CEO) Howard Schultz is the 5th largest shareholder of the company, owning 36.4 mn shares which represent approximately 2.56% of the total number of common shares outstanding (1,422 mn). The current CEO Kevin Johnson, who served as the company’s president and Chief Operations Officer as well as a board member under Schulz’ candidacy as CEO, holds 180,000 shares and has no relationship to the company’s remaining investors. Until today, the company does not have any preferred stocks outstanding.

The Sector

Sector Analysis

Starbucks Corporation classifies in the U.S. Restaurants – Consumer Discretionary sector, thereby competing in the global fast food and restaurant industry with the retail premium coffee and snacks store market being the company’s main operating segments. In order to understand the macroeconomic drivers, which are expected to shape the industry during the upcoming years, it is important to highlight three distinct pillars.

Firstly, it is to highlight that the consumer discretionary sector is a leading indicator for U.S. economic growth. As Figure 4 depicts, from 2014 onwards, U.S. personal consumption expenditures kept increasing and as of October 2017, consumption has already accounted to 69.25% of U.S. GDP. In addition to that, inflation adjusted GDP is expected to grow positively from 2018 until 2022 in all the regions Starbucks and its peers are operating in (Figure 5). Based on that, the positive sales growth assumptions, especially in the Asia Pacific region with an expected inflation adjusted GDP growth of 5.5% per year until 2022, are well-grounded. The section *Determination of Value Drivers and Forecasting* of this report is going to analyse sales growth drivers in the respective regions in more detail.

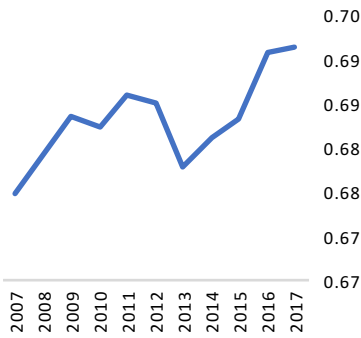


Figure 4: U.S. Personal Consumption Expenditure / GDP in bn of USD / USD bn
Source: Federal Reserve

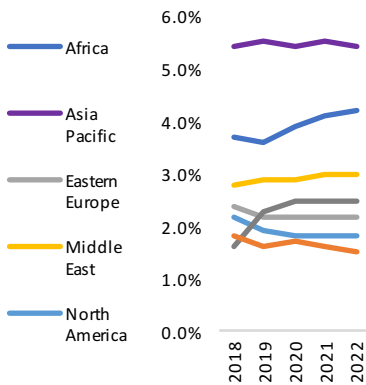


Figure 5: Real GDP Growth per Region
Source: International Monetary Fund

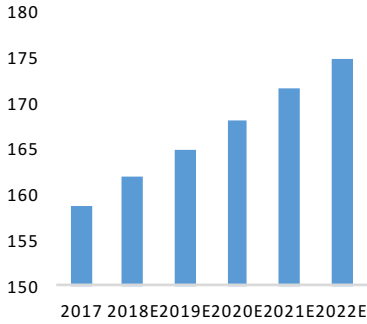


Figure 6: Consumption in mn 60kg bags

Source: Statista

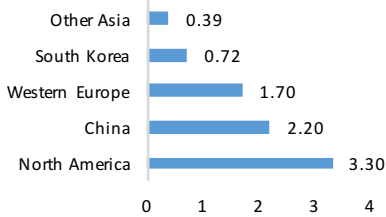


Figure 7: Regional Contribution to Value Growth (in USD bn)

Source: Statista

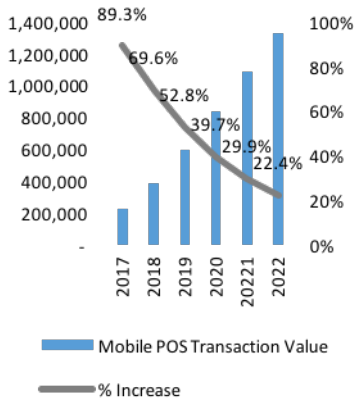


Figure 8: Expected Transaction Value of Mobile POS (in USD mn)

Source: Statista

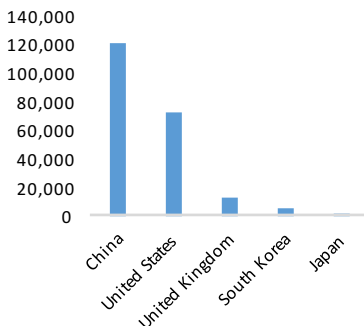


Figure 9: Global Comparison in Transaction Value (in USD mn)

Source: Statista

Secondly, global coffee consumptions has been increasing from 146.98 mn 60kg bags in 2013 up to 155.71 mn 60 kg bags in 2016 and is expected to increase with an compound annual growth rate of 1.94% reaching a consumption of 171.43 mn 60kg bags in 2022 (Figure 6). Specialist coffee shops were the fastest growing major restaurant category in terms of global sales with an overall increase of 9.1% from 2015-2016, whereas the international restaurant industry in general only grew at 5.7% (Euromonitor International Data). In addition to that, the specialist coffee shops category also grew significantly more than the global fast food category (5.8%). As Figure 7 shows, this growth is expected to continue up until 2022 in all regions Starbucks is operating in, where the CAP region will contribute USD 3.7 bn in new value growth, which is mainly driven by China (USD 2.2 bn) and South Korea (USD 715 mn). Furthermore, North America (USD 3.3 bn) as well as Western Europe (USD 1.7 bn) display important growth opportunities for internationally operating specialist coffee shops such as Starbucks Corporation. Therefore, a worldwide increasing appetite for specialist coffee shops which goes hand in hand with great public acceptance and an overall positive economic outlook, determine significant growth potential for Starbucks Corporation to expand its brand internationally.

Thirdly, a further important driver, which will shape the consumer discretionary industry in the medium- and long term, is the mobile and order point of sale (POS). The Mobile POS Payments segment includes transactions at point-of-sale that are processed via smartphone applications. This is especially important for specialist coffee shops to generate customer data and track the respective purchasing behaviour. Some of the dominant international players within the speciality coffee segments, such as Starbucks Corporation, Dunkin' Donuts, as well as McDonald's have introduced mobile and order POS application to stimulate revenue growth. As Figure 8 shows, in 2017 worldwide the total transaction value within this segment amounted to USD 230,820 mn, which represents a total increase of 89.25% from USD 121,962.8 mn in 2016. Up until 2022, it is expected that the total transaction value will amount USD 1,328,243.8 mn, which represents a compound annual growth rate of 41.91%.

Hence, it is important to mention that there is a huge growth possibility for speciality coffee shops over the next five years, because even though the transaction value will increase in absolute terms, it will only grow at a decreasing rate reaching a growth of 22.4% in 2022. Figure 9 illustrates the five largest contributors to mobile POS transaction value. Most of the increase in mobile POS is generated by China (USD 120,851,1 mn) and followed by the United States (USD 72,232.2 mn).

This digital growth opportunity complements the before mentioned increased appetite for speciality coffee shops and the positive economic outlook both in the United States and the Asia Pacific region. Having identified the value drivers within the consumer discretionary industry especially for specialist coffee shops, the following section of this report is going to analyse Starbucks' closest peers in more detail.

Comparables

The companies identified to be the main publicly traded competitors for Starbucks Corporation are McDonald's Corporation with its McCafé segment, Restaurant Brand International Inc. with the Canadian coffee store chain Tim Hortons, Withbread Plc with its brand Costa Coffee, as well as the Dunkin Brands Group. Nevertheless, these companies do have other firms in their portfolio, so that a 1:1 comparison to Starbucks Corporation is not appropriate. In addition to the listed competitors analysed below, Starbucks is also competing with several private speciality coffee shops such as Caffe Nero (total revenues of USD 390 mn), Gloria Jean's Coffees (total revenues of USD 310 mn) and Doutor Coffee Shop (total revenues of USD 718 mn), where the latter two have a strong presence in the Asia Pacific region.

Firstly, McDonald's, as being global fast food chain, operates 36,899 restaurants in 120 countries all over the world. Even though the franchise restaurant industry is characterized by higher EBITDA margins, McDonald's achieves an EBITDA margin of 37.6% (Figure 10). The difference to Starbucks Corporation is that McDonald's has a franchise system in place, so that the company only owns 15% of its restaurants and 85% of these restaurants are owned by franchisees. The franchisees are responsible for paying salaries, ordering supplies and paying rent as well as paying for the premises. Since the aforementioned costs are transferred to the franchisee, the EBITDA margin is higher than the one of Starbucks Corporation (23.67%). Nevertheless, with its McCafé business, which accounts for approximately 6% of the company's total revenues, McDonald's is one of Starbucks closest competitors.

Secondly, in terms of product offerings and their overall business strategy, Dunkin' Donuts (Figure 11) and Starbucks Corporation are very similar. Nevertheless, there are significant differences in the respective business models in terms of scale and store ownership. Since Starbucks is expanding heavily in foreign regions such as Asia Pacific, the overall store count as of 2016 is 25,085, whereas Dunkin' Donuts only operates 11,500 stores. In addition to that, 79% of Dunkin' Donut's revenues are realized within the United States.

USD mn	2015	2016
Sales	25,413.0	24,622.0
Sales Growth	-7.4%	-3.1%
EBITDA	8,714.6	9,261.0
in %	34.3%	37.6%
ROIC	16.8%	19.2%

Figure 10: McDonald's
Source: Company Data

USD mn	2015	2016
Sales	811.0	829.0
Sales Growth	8.3%	2.2%
EBITDA	364.8	457.3
in %	45.0%	55.2%
ROIC	7.4%	8.0%

Figure 11: Dunkin' Donuts
Source: Company Data

USD mn	2015	2016
Sales	4,052.2	4,145.8
Sales Growth	3.0%	2.3%
EBITDA	1,666.2	1,882.2
in %	41.1%	45.4%
ROIC	6.9%	7.0%

Figure 12: Restaurant Brands International
Source: Company Data

BP mn	2015	2016
Sales	2,608.0	2,922.0
Sales Growth	13.7%	12.0%
EBITDA	644.3	722.9
in %	24.7%	24.7%
ROIC	16.1%	13.8%

Figure 13: Whitbread Plc
Source: Company Data

Furthermore, Dunkin' Donut's revenues are generated by 75% of franchise fees and royalty income. As of 2016, 51% of Starbucks stores were company-operated. This also explains the huge dispersion in EBITDA margins.

Thirdly, the same explanation for franchise stores holds for Restaurant Brands International (Figure 12), which holds the coffee chain Tim Horton and Burger King in its portfolio. From the USD 4,145.8 mn in sales, 72% were attributed to Tim Hortons and therefore, to the coffee segment.

Finally, Whitbread Plc. (Figure 13) is the UK's largest operator of hotels, restaurants and coffee shops. The company holds Costa Coffee in its portfolio, among others. With an overall revenue of BP 1,201.7, Costa Coffee contributes 41.13% to Whitbread's overall revenue. Therefore, the company is a close competitor to Starbucks, even though it is to mention that Costa Coffee operates 2,218 stores (62.8% of a total of 3,532) in the United Kingdom, and is thereby not as internationalized as Starbucks.

▪ Trading Comparables Valuation

After having analysed Starbucks closest competitors, this section is going to present a valuation based on the peers' trading multiples. The multiple valuation is based on the law of one price, that comparable companies, which are operating in the same sector and are offering the same product or service, should have the same valuation. Consequently, supplementary to the fundamental analysis, which will be presented in the section Valuation, it is possible to apply an analysis based the comparable firms mentioned above. However, from a valuation perspective it is important to mention that these peers do have other companies in their portfolio and also have significantly different capital structures, which will be analysed in the section *An atypical capital structure*, than Starbucks Corporation, so that this valuation method needs to be treated cautiously. Moreover, the validity of the result depends on the market values of the peers mentioned above, which might be priced incorrectly themselves.

However, it is a useful benchmark for forecasting valuation methods. The fact that it shows a close result (EV/EBITDAR and P/Sales, which are free of financing and some business model effects) to the fundamental analysis can be interpreted as a supporting recommendation for our investment. Figure 14 presents the results.

Company	P/E	EV/EBITDAR	P/Sales
McDonald's	27.27x	14.84x	6.02x
Dunkin' Donuts	26.61x	14.79x	6.58x
Whitbread Plc	15.11x	7.75x	2.20x
Restaurant Brands Int.	36.77x	18.96x	3.26x
Median	26.94x	14.82x	4.64x
Indicative Price	52.80x	61.25x	70.56x

Figure 14: Trading Multiples of Competitors

Source: Bloomberg & Analyst Estimation

Determination of value drivers and forecasting

In order to forecast Starbucks Corporation's revenue development up until 2022, we have identified 3 significant growth drivers, which have been partially mentioned in the *sub-section Sector Analysis* previously. These growth drivers are organic store growth in the regions Starbucks is operating in, increased digitalization, as well as an increase in average ticket size, mainly driven by the new food offerings Starbucks announced to launch from 2018 onwards. With the procedure described in the following, we guarantee that the revenue forecast up to 2022 follows the general methodology: Total revenues per region = # of stores per region X transactions per store per period X average ticket per transaction.

The methodology to quantify these drivers as presented below focuses on company-operated stores in the Americas region. However, the same methodology has been applied to licensed stores in the Americas region, as well as to forecast overall revenues in the CAP region, in the EMEA region and in Others, adjusted for the respective organic store growth in the region under analysis.

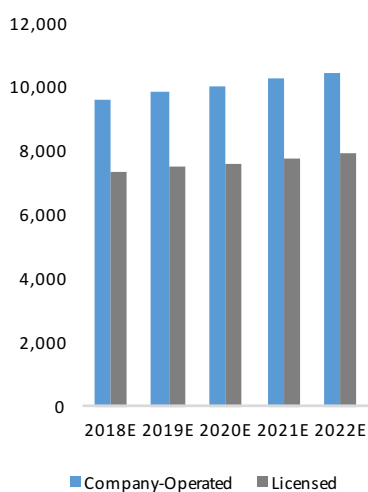


Figure 15: Store Forecast Americas (in Number of Stores)

Source: Analyst Estimation

Organic store growth

Starbucks Corporation's is operating in the brick-and-mortar business and therefore, one of the company's main value drivers is increasing the total number of stores worldwide.

The Americas

Currently, the Americas region is Starbucks' main region displaying the highest number of stores. From 2012 to 2017 the total number of stores increased from 12,903 to 15,607, which represents an increase of 21%.

From 2012 to 2017 the total number of stores increased from 12,903 to 16,559, which represents an increase of 28% at a compound annual growth rate of 5.12%. The Americas has shown only single-digit growth rates recently, so that we let the store count grow at 2.08%, which is also confirmed by Starbucks Corporation. This will lead to a number of total operating stores of 18,354 by 2022, where 10,434 are being company-operated and 7,921 being licensed (Figure 15). As mentioned in the introduction of this section, the respective compound annual growth rate of 2.08% is going to be used as one of the determinant for sales growth in the Americas region.

China / Asia-Pacific

Analysing the China / Asia-Pacific (CAP) region, which represents Starbucks' most significant growth market over the next 5 years, it is important to analyse the rapid expansion the company pursued over the past 5 years. In 2012, Starbucks was just operating 666 company-owned stores and 2,628 licensed stores, which resulted in a total number of stores of 3,294. From then onwards, the company rapidly expanded and as of 2017, Starbucks more than doubled its store count in the CAP region, thereby operating 7,479 stores. As Starbucks announced, by 2019 the company expects to operate a total number of 10,000 stores. It is important to mention at this point, that from 2017 until 2022, the number of company-operated stores will grow at a compound annual growth rate of 21.62%, whereas the number of licensed stores will grow at a compound annual growth rate of 11.11%. As a result, the company is expected to company-operate 8,168 stores and license 7,467 stores by 2022, which leads to an overall store count of 15,635 (Figure 16).

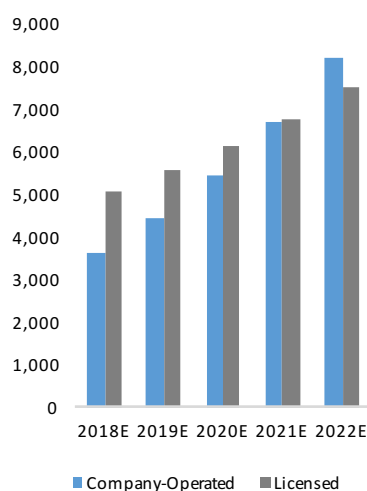


Figure 16: Store Forecast CAP (in Number of Stores)

Source: Analyst Estimation

EMEA

Starbucks' performance in the EMEA region is by far not as good as in the other respective markets the company is operating in. In 2017, the company displayed an operating margin of 11.45% in the EMEA region. From 2012 to 2017, the company significantly decreased the number of company-operated stores from 882 to only 502. At the same time, the number of licensed stores increased from 987 to 2472. Especially in the core Middle European markets, such as France, Germany and Switzerland, Starbucks significantly decreased its number of company operated stores and switched to licensed stores. The reason for this initiative is that Starbucks wants to rely on its licensees' country knowledge to meet individual consumer preferences, which differ within the multicultural EMEA region. As a result, in the EMEA region Starbucks is expected to have a total

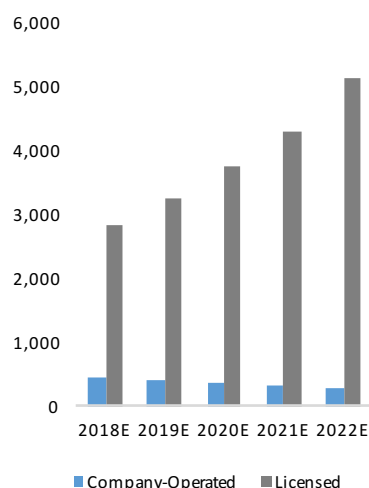


Figure 17: Store Forecast EMEA (in Number of Stores)

Source: Analyst Estimation

number of stores of 5,410 in 2022, whereof 5,125 are expected to be licensed and only 286 to be company-operated (Figure 17). With this move, we expect operating margins in the EMEA region to rise again to 26.64%, which is mainly driven by reduced operating expenses, which are being transferred to the licensees. Furthermore, Starbucks wants to significantly lower its maintenance capital expenditures as well as its expansion capital expenditures, which will be transferred to the licensee in the respective countries. As a result from 2017 to 2022 onwards, depreciation attributable to the EMEA region is expected to decrease from USD 31.3 mn to USD 24.98 mn in 2022. Furthermore, it is important to highlight that the eastern countries of the EMEA region do display significant store growth opportunities for Starbucks.

Until 2022, Qatar (with an expected number of licensed stores of 130), Romania (130), Russia (158), Saudi Arabia (325) and especially Turkey (518), will tremendously influence the success of expansion. Most importantly, the United Kingdom with an expected licensed store count of 981 until 2022 significantly determines the success of Starbucks' performance in the EMEA region. The compound annual growth rates of company-operated stores (-18.99%) and licensed stores (15.70%) are used as an input factor for the overall revenue forecast. The same methodology holds for the region Other, where Starbucks is expected to company-operate 101 stores (compound annual growth rate of -18.99%) and license 49 stores (compound annual growth rate of 5.71%).

Increased Digitalization

The second pillar of Starbucks value creation is the increased investment in the company's digital strategy. The digital transformation for Starbucks is in line with the general change in customer behaviour, which was analysed in the section Sector Analysis at an earlier stage of this report. As a result, over the years the company has developed customer-centric digital strategies, such as free Wi-Fi stores, as well as a mobile application, which is helping the company to adapt to and increase traffic in its stores. Consequently, Starbucks has become a market leader in mobile applications in the fast-food and fast-casual restaurant industry. Within its mobile application and loyalty program called Starbucks Rewards, loyal customers can reach green and silver levels, which offers them benefits, such as free refill tea and brewed coffee, among others. In the United States alone, the company counts 12.3 mn active members in 2017 with a compound annual increase of 18%, which will lead to 28.1 mn expected active users by 2022.

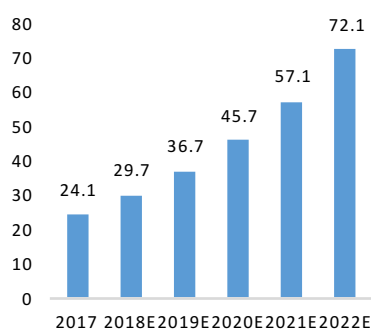


Figure 18: Expected Number of Starbucks App Users Worldwide

Source: Company Data and Analyst Estimation

Therefore, we expect the user base to grow with the number of stores worldwide. As Figure 18 shows, Starbucks is expected to have 72.1 mn app users by 2022 worldwide, which represents a compound annual increase of 24.46%.

The digital transformation will improve operational efficiencies for the business. The significant improvements in order processing and payment will lead to a reduced time of customers being in queues, resulting in a reduced order processing time for the baristas working in the stores. Therefore, the Starbucks application has become a major source of order and pay for in-store purchases in the United States, representing a total of 10% of all transactions in 2017, which corresponds to a 6% increase from 2016. In 2017, Starbucks Corporation reported an average of 500 daily transactions per store in the Americas region, where on average 10% of these transactions are paid with the Starbucks application. Consequently, a 6% increase in app based payments is in line with 30 new app based transactions in the end of 2017. The research¹ conducted for this report reveals, that out of 107 respondents, 15% drop out of the waiting line because they do not get their coffee served within 5 minutes or less. Therefore, it is assumed that the total number of daily transactions could have amounted up to 588, where the difference of 88 represents the loss of customers per day per store.

As a result, with the increase in digital app based payment Starbucks is expected to generate 15% out of the before mentioned 30 new app based transactions as new customers, who would have been lost without the digital increase. Finally, the increase in app based payment in 2017 has led to an increase of 4.5 new transactions per day. Figure 19 displays the expected development of the number of transactions per store until 2022. As Figure 20 illustrates, the loss of potential customers reduces by 0.75% per year, which corresponds to the higher app usage growth and the translated increase in average customers per day. Hence, the compound annual increase is equal to 0.67%, which positively influences Starbucks' revenue growth.

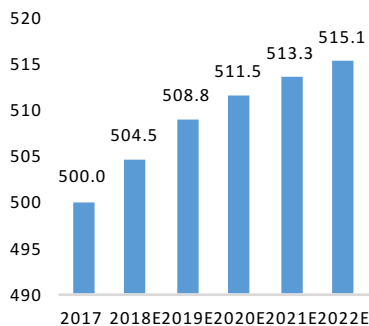


Figure 19: Expected Number of Total Transactions per Day per Store
 Source: Company Data and Analyst Estimation

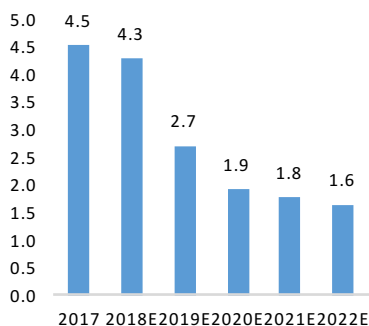


Figure 20: Expected Number of New Transactions Generated per Day per Store
 Source: Company Data and Analyst Estimation

¹ The analysis in this section and the price elasticity analysis with the corresponding test statistics, which is shown at a later section of this report, are based on an online enquiry addressed at students from the Sacred Heart University Connecticut in the United States, at students from Nova School of Business & Economics in Lisbon and at students from the Saïd Business School - University of Oxford. In addition to that, we also collected data from full-time workers in the greater New York area (United States), Lisbon (Portugal) and London (United Kingdom). The questionnaire was open to be answered from the 1st of November until the 30th of November 2017.

Increased average ticket

Starbucks started to launch so-called Starbucks Reserve Roasteries in Seattle, Chicago and Shanghai and it plans to open more locations in Tokyo and New York, as well as in Milan, even though Starbucks right now is not even operating in Italy. Besides the traditional snacks, in 2016 Starbucks became a global licensee and investor in the bakery Princi. Consequently, within these Reserve Roastery stores, Starbucks is going to offer pizza, focaccia sandwiches as well as tiramisu. This will increase the company's brand awareness around the globe, but given its unimportant contribution to value creation, this initiative is not modelled into the average ticket size. Therefore, this section aims at determining the growth in the beverage, food, packaged goods and services segments and other (not including effects of store growth and digitalization) based on the increase in average tickets per transaction. Based on three observations in Starbucks Stores in London, Lisbon, and New York, and the current price list in USD, an average shopping basket has been determined by establishing three distinct customer groups as presented in Figure 21. Please note, that the average customer matches the company's current revenue split (beverage: 74%; food:19%).

Average Ticket 2017 in USD	Average Ticket		
	Group 1	Group 2	Group 3
Coffee / Water	3.75	3.75	3.75
Muffin / Cake	0.00	2.50	0.00
Sandwich (Old)	0.00	0.00	4.00
Total	3.75	6.25	7.75
Weight	70%	15%	15%

Figure 21: Average Ticket in 2017 without Mercato
Source: Analyst Research

Average Ticket 2022 in USD	Average Ticket		
	Group 1	Group 2	Group 3
Coffee / Water	4.35	4.35	4.35
Muffin / Cake	0.00	2.90	0.00
Sandwich (Old)	0.00	0.00	4.64
Total	4.35	7.25	8.98
Weight	70%	15%	15%

Figure 22: Average Ticket in 2022 without Mercato
Source: Analyst Research

On this basis, the increase in average ticket size will incorporate two effects. First, *ceteris paribus*, the average ticket size will grow at an inflation adjusted rate of 3% per annum until 2022. This rate is based on historic averages and assumes that Starbucks's offering remains the same over the years. The results are displayed in Figure 22.

Second, from 2018 onwards Starbucks is going to introduce the new lunch line called Mercato. The new offering will include, compared to today's sandwiches and similar, higher priced foods, such as fresh focaccias and salads. Therefore, the company aims to tackle the lunch business in the respective regions it is operating in and expects food to contribute 25% to total revenues by 2020.

To include this development, we introduced a fourth distinct customer group, which enters Starbucks to get lunch. The average lunch menu is assumed to be around USD 10.15.

This includes an average food price of USD 7.25, based on an analysis of comparable companies, such as Chopt Creative Salad, and additional cross-selling of beverage of USD 2.92, assuming equal probabilities of a customer to choose between a coffee or a water (USD 1.50).

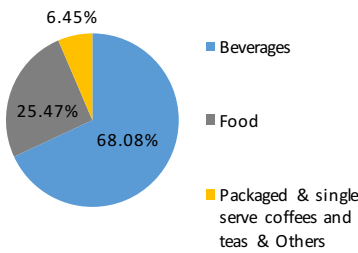


Figure 24: Expected Revenue Mix in 2022
Source: Company Data & Analyst Estimation

Average Ticket 2022 in USD	Group 1	Group 2	Group 3	Group 4
Coffee / Water	4.35	4.35	4.35	2.92
Muffin / Cake	0.00	2.90	0.00	0.00
Sandwich (Old)	0.00	0.00	4.64	0.00
Sandwich / Salad	0.00	0.00	0.00	7.25
Total	3.75	6.25	8.98	10.17
Weight	70%	13%	3%	15%

Figure 23: Average Shopping Basket 2022 After Introduction of Mercato
Source: Analyst Research

Figure 23 displays the four different customer groups with the respective average ticket size by 2022, including the two effects described above. While applying the new weights shown above, the average beverage basket has increased from USD 3.75 to USD 4.13, whereas the average food basket has increased from USD 0.98 to USD 1.57.

Consequently, from the analysis above we can determine the increase in average total ticket size, which has grown at a compound annual growth rate of 3.82%. Furthermore, we can extract the growth in the beverage and food segment, which have grown at a compound annual growth rate of 1.97% and 9.94%, respectively. The strong growth in the food segment is driven by the Mercato line, addressing a complete new customer group. The beverage segment will grow below historic averages, because the food segment increases its revenue share. Figure 24 illustrates the new revenue mix as of 2022.

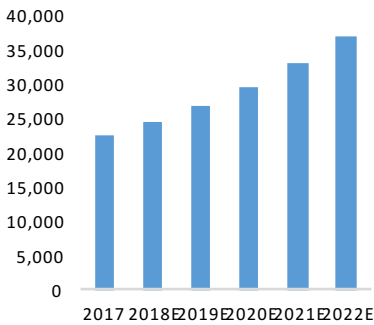


Figure 25: Expected Total Revenues in USD mn
Source: Analyst Estimation

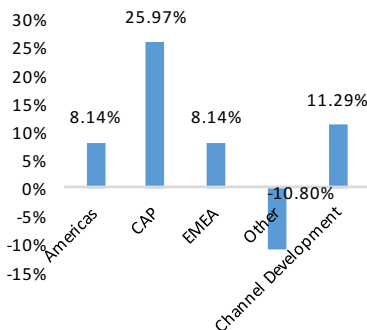


Figure 26: Expected Compound Annual Growth Rate per Region from 2017 to 2022
Source: Analyst Estimation

Financial Projection

Operating Performance Development

Having analysed Starbucks business sector and its future growth pillars, we expect Starbucks Corporation to generate revenues of USD 36,808.3 mn in 2022, which corresponds to a compound annual growth rate of 10.6% (Figure 25). Based on the value drivers mentioned in the previous section of this report, especially the CAP region is expected to grow at an annual compound growth

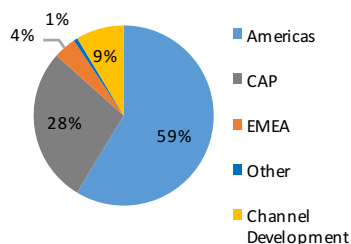


Figure 27: Expected Revenue Split per Segment in 2022
Source: Company Data & Analyst Estimation

rate of 25.97%, showing an overall revenue of USD 10,277 mn in 2022 (Figure 26). Nevertheless, as Figure 27 depicts, the Americas region will still generate the major contribution to consolidated revenues.

Starbucks Corporation’s daily business is partially dependent on the development of the price of coffee, which is the second largest commodity in the world. According to the International Coffee Organization, all coffee is grown in the global south of the world and is mostly consumed in the global north. Coffee production is dominated by Latin American, African as well as Asian countries. Especially Brazil, Colombia and Vietnam are the main exporter with a market share of 30%, 15% and 5%, respectively.

The question arises if any significant changes in the price of coffee could influence Starbucks’ business success. As Figure 28 below illustrates, the price for coffee has shown significant fluctuations with an annual volatility of 24.7% at an annual return of 2.2% from 01/1990 until 12/2017. Unexpected events, such as hurricane Irma in 2017 or any other unfavourable weather conditions especially in Brazil or Colombia could cause a shortage in coffee supply and possibly increase cost of goods sold of speciality coffee shops by 0.54%, which represents an annual return for coffee of 2.71%. Nevertheless, the company reported that for 2018 it has already hedged two thirds of its coffee costs, which contribute only 10% to total costs of goods sold. Therefore, given Starbucks very low exposure to coffee cost volatility, we do not perceive that an increase in coffee prices can significantly harm Starbucks’ overall operating performance. Due to the company’s strong pricing power and corresponding low price elasticity, which is going to be analysed and proved in the consecutive section of this report, even significant price increases for coffee can be transferred to the consumers.

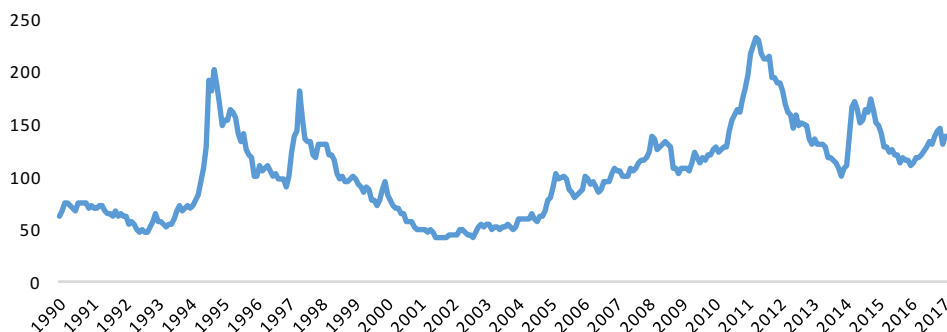


Figure 28: Historical Development of the Price of Coffee in US Cents per Pound (Cts / LB)
Source: International Coffee Organization

Historically, Starbucks has shown a continuous increase both in EBITDA as well as in EBIT margin, where the former has been increasing from 19.16% in 2012 to 23.67% in 2017. EBIT margins has been increasing from 15.02% in 2012 to 19.16% in 2017 and are expected to reach a level of 23.84% in 2022. Therefore, EBITDA is expected to grow from USD 5,299.6 mn in 2017 at a compound annual growth rate of 10.61% to USD 8,775.9 mn in 2022. Nevertheless, we expect only a slight increase in both EBIT and EBITDA margins due to Starbucks reliance on sales leverage. Since Starbucks has high fixed costs (occupancy costs), such as rent and insurance, the company has to generate higher margins with incremental sales. Therefore, with its segment Channel Development Starbucks successfully distributes its ready-to-drink products through supermarkets and speciality retailers, among others. Revenues in Channel Development are expected to grow from USD 2,008.6 mn in 2017 at a compound annual growth rate of 9.55% to USD 3,169.3 mn. Channel Development’s key strength is based on very low operating expenses (non-existence of store operating expenses) as well as low general and administrative expenses, because these two are transferred to third parties, which sell the products in their respective stores. This translates into a EBIT margin of 44.48%, which we expect to reach a level of 48.13% in 2022. As Figure 29 illustrates, Channel Development is by far the most profitable business segment at Starbucks.

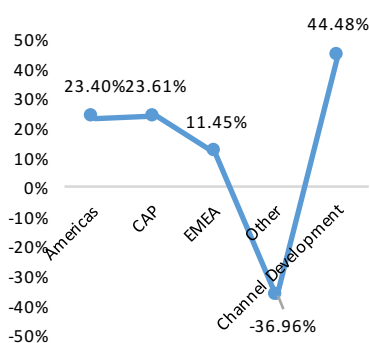


Figure 29: EBIT Margin of Segments as of 2017

Source: Company Data

As Figure 30 illustrates, we expect only a slight increase in both EBITDA and EBIT margins, which are significantly lower than the margins of the company’s closest peers, which is mainly due to their franchising business model, which has been extensively explained in the section *Comparables*.

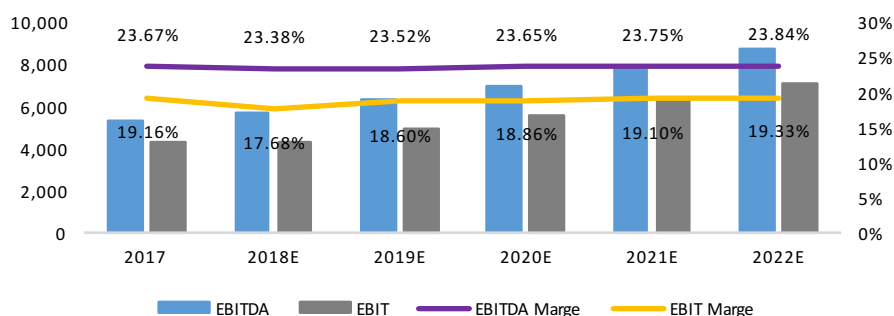


Figure 30: Operating Performance until 2022

Source: Company Data & Analyst Estimation

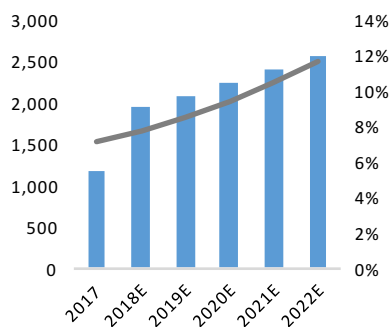


Figure 31: CAPEX Forecast in USD mn
 Source: Analyst Estimation

Furthermore, Starbucks’ rapid expansion during the past years has been characterized by an increasing number of capital expenditures (CAPEX) in addition to already existing Property, Plant & Equipment (PPE). From 2012 to 2017, CAPEX in addition to PPE has been increasing from USD 856.2 mn to USD 1,519 mn, which results in a PPE position of USD 4,919.5 mn in 2017. Previously mentioned, Starbucks is going to consequently open new stores within the next five years. The value of future PPE is meant to be related to the number of new company-operated stores and therefore correlated with Starbucks overall revenues. From 2018 to 2022, Starbucks is expected to further invest in CAPEX to generate organic store growth. As Figure 31 depicts, we estimate CAPEX as addition to PPE to show a value of USD 2,498.19 mn in 2022, which represents an annual compound growth rate of 10.46% from 2017 until 2022.

Price Elasticity Analysis

As mentioned in the previous analyses of this report, Starbucks has been leveraging its consumer loyalty and lack of price elasticity among its consumers by continuously passing on increases in costs, due to wages and coffee prices, to its customers. As a result, in the period between 2014 to 2016, Starbucks determined four price hikes on its products, two of which were in 2016 alone. The rise in prices has been mainly aimed at protecting the company’s operating margins. Nevertheless, there is a very serious concern about how long consumers decide to stick with Starbucks before choosing one of the many competing coffee shops if prices continue to increase at this pace. Even though the main attraction of a Starbucks store is its inviting and premium atmosphere, when the prices rise above a certain threshold, even the most loyal customers could look for alternative premium coffees at one of Starbucks’ competitors.

In order to test whether or not this is a valid risk, statistics have been applied with a sample size of 107. This section of the report analyses the output received from the questionnaire. For the statistical tests, a significance level of 5% was taken as the boundary for rejecting the null hypothesis. Respondents have been given the alternative to choose between a cappuccino of Starbucks Corporation, Dunkin’ Donuts, McCafé and a local brand on a nominal scale. Therefore, three distinct scenarios have been created while applying different prices.

The base case scenario (Figure 32) displays Starbucks’ cappuccino cost of USD 3.15, Dunkin’ Donut’s of USD 2.70, McCafé’s soon to be introduced cappuccino of USD 2.00 and a local brands cappuccino of USD 2.50. Interestingly, 63% of the respondents would chose a Starbucks’, 31% a local brand, 9% McCafé’s cappuccino and only 4% Dunkin’ Donuts’.

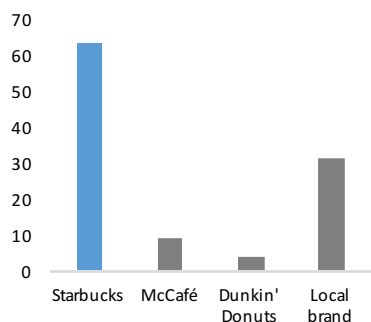


Figure 32: Scenario 1 - Number of Customers Buying Starbucks
 Source: Analyst Estimation

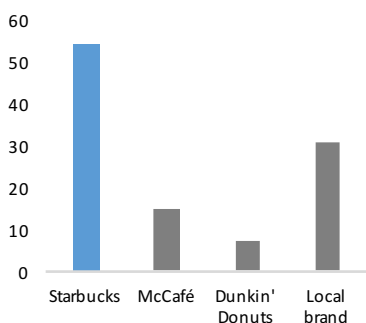


Figure 33: Scenario 2 - Number of Customers Buying Starbucks after Price Hike

Source: Analyst Estimation

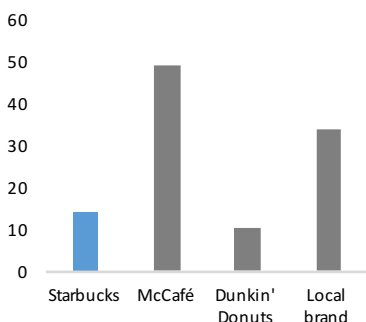


Figure 34: Number of Customers Buying Starbucks After Third Price Hike

Source: Analyst Estimation

The second scenario (Figure 33) displayed Starbucks' cappuccino cost of USD 3.50, Dunkin' Donut's of USD 2.75, McCafé's of USD 2.05 and a local brands cappuccino of USD 2.55. Now, only 54% of the respondents would chose a Starbucks', 31% a local brand, 15% McCafés and only 7% Dunkin' Donuts'.

The third scenario (Figure 34) displayed Starbucks' cappuccino cost of USD 3.85, Dunkin' Donut's of USD 2.80, McCafé's of USD 2.10 and a local brands cappuccino of USD 2.60. Interestingly, only 14% of the respondents would chose a Starbucks', 34% a local brand, 49% McCafé's and 10% Dunkin' Donuts'.

To further continue with the analysis, a Chi-Square Goodness of Fit Test has been applied in the three different scenarios. In scenario one, it was assumed that respondents would be indifferent between choosing one or the other brands and that, as a result, each brand would be chosen with the same frequency. The test statistics, however, show that the observed values differ and that the null hypothesis, that 25% of the respondents would choose Starbucks, can be rejected. When looking at the observed frequencies, one can find strong support for the alternative hypothesis that more than 25% of the respondents would choose Starbucks. In scenario two, it was assumed that respondents would stick with their preference made in scenario one and, thus, that the price increase would not influence their preferred choice. Hence, the observed values from scenario one have been used as expected values in scenario two. With a p-value of 5.7%, one fails to reject the null hypothesis, meaning that the observed values in scenario two do not significantly differ from the observed values in scenario one. This indicates that Starbucks customers do not significantly change their product decision when faced with a price increase of USD 0.35 and stay loyal towards Starbucks, even though some people changed their purchasing decision in absolute values. The analysis was continued in scenario three, once again assuming that respondents would not change their preferred choice despite a price increase. Thus, the observed values from scenario two have been used as expected values in scenario three. The test statistics, however, show that this null hypothesis can be clearly rejected and, as a result, one can observe a highly significant change in customers' purchasing decision. Starbucks customers, who stood loyal with the company after the first price increase of USD 0.35, now switched to the company's competitors.

Additionally, Chi-Square Tests of Independence have been applied to determine whether or not the preferred choice in the three distinct price scenarios mentioned above was independent of the demographics of the respondents. The six different demographics were used as independent variables to split the sample into two or more distinct groups, while the dependent variable was the preferred choice of coffee, measured on a nominal scale and recoded into either

choosing Starbucks or choosing any other brand. Out of the six tested demographics, two were of particular interest, namely being a loyal Starbucks customer and the respondents' income, both measured on an interval scale. The test statistics show that the results for the two demographics are very similar. In both scenario one and two, the null hypothesis that the preferred choice is independent of the demographic can be rejected for being a loyal Starbucks customer and the respondents' income. When looking at the crosstabs (Figures 35-38), one can see that both loyal Starbucks customers, defined as those visiting Starbucks at least once per week, as well as those with a moderate-high income, i.e. those with a monthly income of at least USD 2,000, are more likely to choose Starbucks over any other brand in both price scenarios, while the opposite is true for no-Starbucks customers and low-income respondents.

Frequency	Starbucks	Other	Total
Less than 1 time per	16	40	56
Between 1 to 3 times	41	2	43
More than 3 times per	6	2	8
Total	63	44	107

Figure 35: Frequency of visiting Starbucks per Week in Scenario 1
 Source: Analyst Research

Frequency	Starbucks	Other	Total
Less than 1 time per	11	45	56
Between 1 to 3 times	37	6	43
More than 3 times per	6	2	8
Total	54	53	107

Figure 36: Frequency of visiting Starbucks per Week in Scenario 2
 Source: Analyst Research

Income	Starbucks	Other	Total
below USD 1,000	16	24	40
USD 1,000 to 2,000	5	8	13
USD 2,001 to 3,000	23	5	28
USD 3,001 to 4,000	12	2	14
above USD 4,000	7	5	12
Total	63	44	107

Figure 37: Number of People choosing Starbucks in Scenario 1 based on Monthly Income
 Source: Analyst Research

Income	Starbucks	Other	Total
below USD 1,000	13	27	40
USD 1,000 to 2,000	4	9	13
USD 2,001 to 3,000	20	8	28
USD 3,001 to 4,000	11	3	14
above USD 4,000	6	6	12
Total	54	53	107

Figure 38: Number of People choosing Starbucks in Scenario 2 based on Monthly Income
 Source: Analyst Research

Income	Starbucks	Other	Total	Frequency	Starbucks	Other	Total
below USD 1,000	13	27	40	Less than 1 time per	7	49	56
USD 1,000 to 2,000	4	9	13	Between 1 to 3 times	5	38	43
USD 2,001 to 3,000	20	8	28	More than 3 times per	2	6	8
USD 3,001 to 4,000	11	3	14	Total	14	93	107
above USD 4,000	6	6	12				
Total	54	53	107				

Figure 40: Frequency of visiting Starbucks per Week in Scenario 3
 Source: Analyst Research

Figure 39: Number of People choosing Starbucks in Scenario 3 based on Monthly Income
 Source: Analyst Research

However, this changes significantly in scenario three. Here, the test statistics for both demographics clearly show that one fails to reject the null hypothesis, indicating that the preferred choice of coffee in this scenario is independent of the respondent being a loyal Starbucks customer as well as his or her income. In fact, one can see from the frequency table as well as the crosstabs (Figures 39-40) that the large majority, i.e. 86.9% of respondents, would now choose a coffee from any other brand than Starbucks and that even loyal Starbucks customers as well as respondents with moderate-high income are switching to the company’s competitors.

McDonald’s offering a new cappuccino could jeopardize Starbucks’s performance

Overall, this sensitivity analysis bears testimony to the assumption that Starbucks cannot increase its prices indefinitely without its customers looking for alternatives elsewhere. This threat is about to become reality, when McDonald’s is going to introduced its McCafé cappuccino in January 2018. The company’s increased focus on coffee can ease the pressure on McDonald’s food sales and the price advantage can draw customers from Starbucks and Dunkin’ Donuts. As the statistics have shown, after the first price increase by 11.11% from USD 3.15 to USD 3.50, Starbucks customers started switching, even though not statistically significant, to other brands. More importantly after the second price increase by 7.14% from USD 3.50 to USD 3.75, one could observe a significant change from Starbucks to McCafé’s newly introduced cappuccino, where Starbucks lost 37.4% of its customers within the sample resulting in an absolute decrease from 54 to only 14 respondents. Consequently, one has to notice that Starbucks will experience huge competition from McDonald’s from January 2018 onwards, since customers, which do not agree to stand further price hikes up to USD 3.75 per cappuccino, are going to evaluate McCafé as a substitute for Starbucks.

An atypical capital structure

Highly Unlevered Balance Sheet

The strength of Starbucks balance sheet can be evaluated by looking at both the capital structure and the working capital. Starbucks displays a debt-to-equity ratio based on market values of 4.62%. As Figures 41 shows, Starbucks Corporation has a highly unlevered capital structure, a value way lower than the comparable companies' average, which display a debt-to-equity ratio based on market values of 29.4% on average, Dunkin' Brands Group Inc. showing the highest one with 45.8%. The lowest among the five peers is maintained by Whitbread Inc. with 15.9%. Consequently, Starbucks significantly maintains by far the lowest market debt-to-equity ratio among its closest competitors.

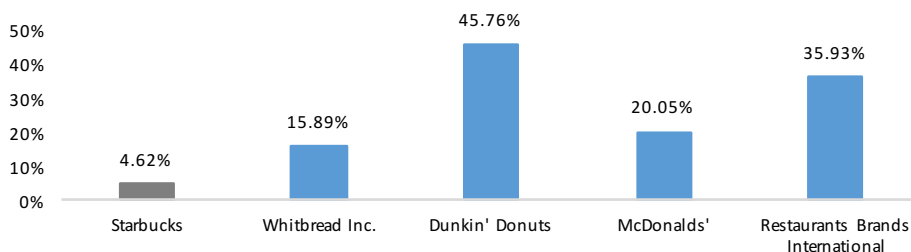


Figure 41: Debt-To-Equity Comparison Based on Market Values
Source: Bloomberg

The analysis of Starbucks balance sheet reveals that the company shows a net debt of only USD 220 mn (including short term and long term investments). In addition to that, Starbucks shows a high market value of equity position. When comparing the development of the historical book values of both debt and equity, we clearly see that the book value of debt continuously converged towards the book value of equity. In 2017, Starbucks shows a debt-to-equity ratio in book values of 79.73%, where the book value of debt is USD 4,687.9 mn and the book value of equity USD 5,879.6 mn (Figure 42). This development indicates that Starbucks' market value of equity is significantly higher than the corresponding market value of debt.

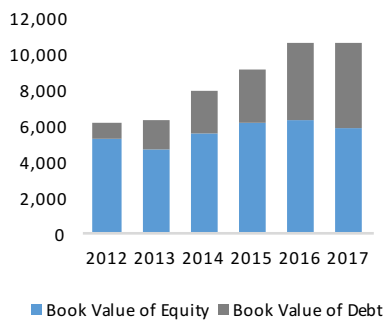


Figure 42: Historical Development of Book Value of Equity and Debt
Source: Company Data

To further analyse Starbucks' debt-to-equity ratio, it is necessary to focus on the equity position of the balance sheet as far as stock repurchases and dividends are concerned. Starbucks is well-known for its consistent history of paying out dividends as well as repurchasing common stocks. To do so, the company announced the closing of an underwritten public offering of USD 500 mn of 2.2% senior notes due in 2020 and USD 500 mn of 3.75% senior notes due in 2047.

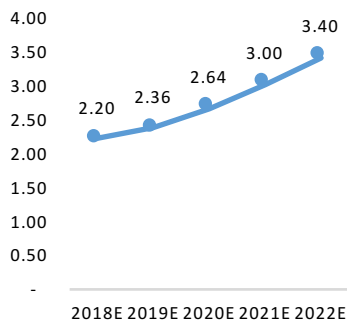


Figure 43: Earnings per Share Forecast in USD

Source: Analyst Estimation

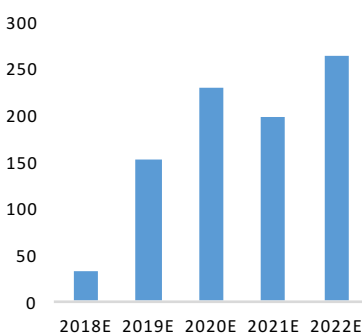


Figure 44: Change in Net Working Capital Investments until 2022

Source: Analyst Estimation

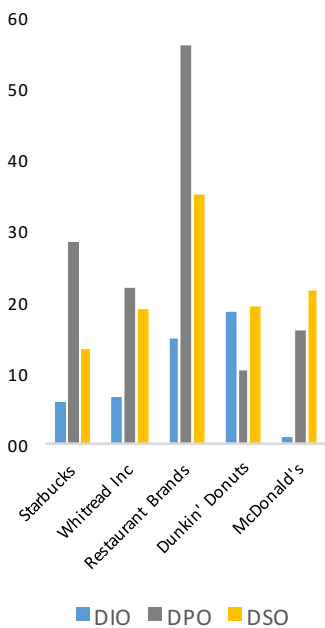


Figure 45: Trade Capital Analysis in Days

Source: Bloomberg

From 2018 to 2020 the company plans to pay its shareholders a total amount of USD 15 bn, characterized by constant dividend payments of USD 1.2 per share per year and stock repurchases, which are partially financed with the soon to be introduced senior notes. However, our analysis reveals that Starbucks is expected to issue another USD 2,200 mn to even finance the repurchase and dividend program of USD 1,500 mn. As Figure 43 illustrates, we expect the earnings per share to grow from USD 1.99 in 2017 to USD 3.40 in 2022.

Strong Trade Working Capital Management

A further determinant for value creation lies in a company's ability to optimize its working capital, which is a key determinant of free cash flow. Starbucks' working capital management, characterized by current operating assets minus current operating liabilities, is characterized by a high negotiation power in comparison to its close competitors. Figure 44 displays the expected change in net working capital investments until 2022. As this report has shown, a 1:1 comparison to its competitors is not sufficient. Therefore, a trade working capital benchmarking analysis has been applied to investigate the companies' inventory management, payables management as well as receivables management. On the one hand, the days sales outstanding (DSO), calculated by accounts receivables in relation to total revenues, has been 12.98 days in 2017. On the other hand, the days payables outstanding (DPO) has been increased significantly from 2012 (24.7) to 2017 (31.2). This indicates that Starbucks is able to quickly convert its accounts receivables into cash while at the same time extends its mandatory bills to suppliers. Hence, the payables, which can be interpreted as non-interest bearing loans, are paid 18.22 days later on average than receivables are converted into cash (Figure 45).

Furthermore, among its closest peers, Starbucks Corporation shows day inventory outstanding of 6.6 which is below the other companies' numbers as well as below the median of 6.8 days. This indicates that Starbucks is able to convert its inventory into cash more quickly than Whitbread Inc. (6.8 days), Restaurant Brands (15.0 days) and Dunkin' Donuts (18.7 days). Nevertheless, McDonald's only needs 1.3 days to convert its inventories into cash, which is significantly better than Starbucks performance. Restaurant Brands International clearly outperforms Starbucks and the other peers with days payables outstanding of 56.2. However, it takes Starbucks 31.2 days to pay its bills, which indicates its strong performance when compared to Whitbread Inc. (22.2 days), McDonald's (16.1 days) and Dunkin' Donuts (10.4 days), thereby showing a better performance than the median payables outstanding of 22.2 days.

Finally, Starbucks shows the greatest performance in being quickly able to collect money from its clients (12.98 days). Whitbread Inc. (19 days), Dunkin’ Donuts (19.3 days), McDonald’s (21.6 days) and Restaurant Brands International (35 days) significantly take longer to convert its receivables into cash. Overall Starbucks’ trade capital is very efficient when compared to its closest competitors.

The cost of capital

Starbucks Corporation’s weighted average cost of capital can be determined by estimating the specific methodologies to arrive at the input factors, such as the levered cost of equity, beta, as well as the cost of debt.

Starting with the levered cost of equity, the Capital-Asset-Pricing Model has been applied. For the risk-free-rate, we have used the yield to maturity of the 10-year U.S. government rate, which trades at 2.35%. In order to determine Starbucks’ levered beta, Starbucks’ daily returns have been regressed against the daily returns of the S&P 500 over the past 10 years. The resulting beta is 1.057.

To cross-check the result achieved, the levered betas of 5 industry peers, such as Whitbread PLC, Restaurant Brands International, Dunkin’ Brands Group Inc., McDonald’s Corporation as well as Compass Group PLC, have been unlevered. After that the average of these results has been applied to Starbucks’ market debt-to-equity ratio of 4.62%, which yields a levered beta of 0.68. Figure 46 shows both the unlevered and levered betas of Starbucks’ peers. Due to the fact that Starbucks does not have perfectly comparable peers, this approach yields significantly differing results and is not suitable to determine the company’s levered beta.

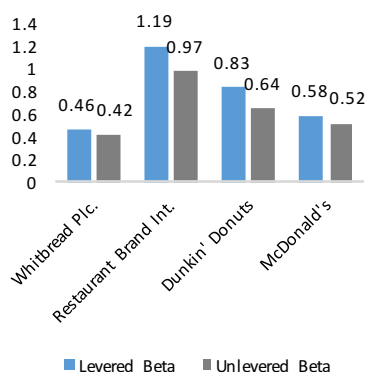


Figure 46: Unlevered and Levered Betas of Peers
Source: Bloomberg & Analyst Calculation

In order to determine the risk premium, the daily return of the risk-free rate (10 Year US Government Bond) has been subtracted from the daily returns of the S&P 500 over an investment horizon of 10 years and finally annualized, which yields a risk premium of 4.90%. Finally, Starbucks’ levered cost of equity is 7.53%. It is important to mention that the 95% confidence interval yields betas of 1.102 (upper 95%) and 1.011 (lower 95%).

	Beta	Upper 95%	Lower 95%
Daily	1.057	1.102	1.011
Weekly	1.034	1.259	0.808
Monthly	1.073	1.162	1.029

Figure 47: Betas Using Different Observations
Source: Bloomberg

Additionally, to testify the accuracy of the beta of 1.057, the same methodology as mentioned above has been applied using weekly observations over a two year horizon and monthly observations over a five year period. Figure 47 displays the results.

Therefore, a sensitivity analysis (Figure 48) with slightly increasing risk-free rates, which is based on the Federal Reserve’s motive to stop quantitative easing, and

levered betas has been applied to show possible levered costs of equity for Starbucks.

Rf / Beta	1.0107	1.0209	1.0311	1.0413	1.0514	1.0616	1.0718	1.0820	1.0922	1.1024
2.30%	7.25%	7.30%	7.35%	7.40%	7.45%	7.50%	7.55%	7.60%	7.65%	7.70%
2.38%	7.33%	7.38%	7.43%	7.48%	7.53%	7.58%	7.63%	7.68%	7.73%	7.78%
2.46%	7.41%	7.46%	7.51%	7.56%	7.61%	7.66%	7.71%	7.76%	7.81%	7.86%

Figure 48: Sensitivity of Cost of Equity with Changing Risk-Free-Rate and Beta

Source: Bloomberg

Continuing with Starbucks Corporation's cost of debt, the yield of maturity of the company's latest issued bond has been used (2.88%). In addition to that, Starbucks' debt beta has been approximated by comparing it to the debt beta of other firms with the same credit rating of A- do have. This resulted in a debt beta of 0.0316. After that, the same methodology has been applied as when calculating the levered cost of equity. Consequently, Starbucks' pre-tax cost of debt yields 2.50%. In order to cross-check this result, the yield to maturity of other companies representing the S&P 500 with a credit rating of A- has been determined, where the average yield to maturity has been 2.73%, which is approximately in line with Starbucks Corporation's yield to maturity of 2.88%.

Since Starbucks Corporation is a company with a significant low level of leverage, the company's debt-to-enterprise value ratio is 4.42% and the corresponding equity-to-enterprise value ratio is 95.58%. Taking into account the statutory tax rate of 35% as well as the aforementioned capital structure, with a market value of debt of USD 3,776.6 mn and an equity value of USD 81,665.5 mn, the weighted average cost of capital of Starbucks is 7.28%.

Valuation

Significant upside potential with expected share price of USD 69.16

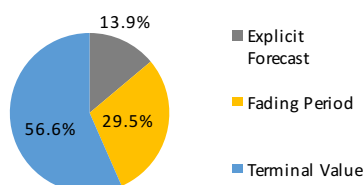


Figure 49: Contribution to Enterprise Value

Source: Analyst Estimation

In order to value Starbucks Corporation, the fundamental analysis in form of a Discounted Cash Flow Analysis has been applied. Therefore, the explicit forecast period ranges from 2018 to 2022. From 2023 onwards, a ten-year fading period for mid-term cash flows until 2032 has been incorporated into the model, as well as a terminal value with a perpetual growth rate of 2%, which is in line with the forecasted inflation rate. These cash flows are discounted using a WACC of 7.28%, which has been elaborated on in the section. The sum of the respective discounted future cash flows and the terminal value provides a total enterprise value of USD 102,947.6 mn. Consequently, by adding the net financial assets, the resulting equity value is equal to USD 98,341.0 mn. With a total number of shares outstanding of 1,422 mn, the corresponding share price is equal to USD 69.16. Figure 49 on the left displays the value contribution of the three specific forecasting periods mentioned above. Due to the fact that 56.6% of Starbucks' overall value lies in the long-term future, Figure 50 illustrates the company's stock price sensitivity to changes in the weighted average cost of capital and terminal growth.

		Terminal Value						
		1.94%	1.96%	1.98%	2.00%	2.10%	2.20%	2.30%
WACC	6.98%	73.28	73.52	73.76	74.00	75.26	76.57	77.93
	7.08%	71.62	71.85	72.08	72.31	73.51	74.76	76.06
	7.18%	70.03	70.25	70.47	70.69	71.84	73.03	74.26
	7.28%	68.50	68.71	68.92	69.13	70.22	71.36	72.54
	7.38%	67.03	67.23	67.43	67.63	68.68	69.76	70.89
	7.48%	65.61	65.80	65.99	66.19	67.19	68.22	69.30
	7.58%	64.24	64.42	64.61	64.79	65.75	66.74	67.78

Figure 50: Starbucks Share Price Sensitivity to WACC and Terminal Growth in USD

Source: Analyst Estimation

Scenario Analysis: CAP region grows less than expected

As this report has shown, Starbucks' main revenues are generated in the Americas region, especially in the United States. Generally, developed countries show a more predictable growth than emerging markets such as the China/ Asia Pacific region. Since Starbucks plans to heavily expand in this region until 2022, we expect the company to operate 8,168 company-operated stores and 7,467 licensed stores. As our analysis has shown, both the economic outlook as well as the increasing appetite for specialist coffee shops in the CAP region are in favour of huge growth opportunities for Starbucks Corporation. Nevertheless, Figure 51

demonstrates a sensitivity of the share price if the compound annual store growth rate deviates from the forecasted rates for company-operated (21.62) and licensed stores (11.11%). When starting from the base case scenario (0% deviation from company-operated and licensed store growth rate), it becomes visible that a decline in growth is more critical for company-operated stores. Since we project a strong store growth in the CAP region until 2022, we deem it necessary to show price scenarios when the compound annual store growth rate deviates from the base scenario.

		Company-Operated						
		-3.00%	-2.00%	-1.00%	0.00%	1.00%	2.00%	3.00%
Lic.	-3.00%	58.01	61.25	64.71	68.39	72.33	76.53	81.00
	-2.00%	58.23	61.48	64.94	68.64	72.58	76.78	81.26
	-1.00%	58.47	61.72	65.19	68.89	72.83	77.04	81.53
	0.00%	58.72	61.98	65.45	69.16	73.11	77.32	81.81
	1.00%	58.99	62.25	65.73	69.44	73.39	77.61	82.11
	2.00%	59.26	62.53	66.01	69.73	73.69	77.92	82.42
	3.00%	59.55	62.82	66.31	70.04	74.01	78.24	82.75

Figure 51: Share Price Sensitivity to Growth in Company-Operated and Licensed Stores in CAP Region in USD

Source: Analyst Estimation

Final Value Considerations

Having explained the main driver of the valuation for Starbucks Corporation, it is also essentially important to assess the reasonability behind the projections outlined in this report.

Therefore, it is important to analyse the implicit returns on invested capital (ROICs) as well as its relative relationship with the cost of capital (WACC), to understand whether or not Starbucks is creating value for its shareholders. Starbucks has a WACC of 7.28%. In 2017, the company displays net operating assets of USD 6,698.5 mn and total net revenues of USD 22,386.8 mn, which results in an asset turnover of 3.3. With an operating margin after tax of 12.15% in 2017, Starbucks' ROIC is 39.13%. Based on this metric, Starbucks clearly outperforms its competitors. From 2018 to 2022 this number is expected to further increase up to 51.13% (Figure 52). Since this value by far exceeds the company's WACC, from a value creation point of view, one can definitely say that Starbucks has still a lot of room to further grow its operations, because as long as ROIC is greater than WACC, the company is always creating shareholder value.

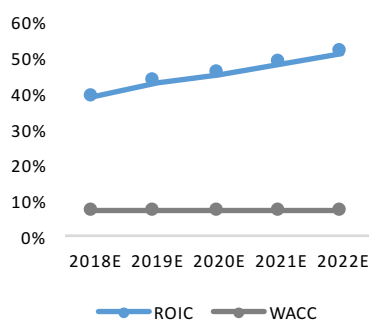


Figure 52: Starbucks' Forecasted ROIC

Source: Analyst Estimation

Appendix

Consolidated Income Statement

Consolidated Profit & Loss Statement (in USD mn)	2017	2018E	2019E	2020E	2021E	2022E
Company-operated stores	17,650.7	19,245.4	21,130.4	23,370.6	26,048.7	29,270.5
<i>% of Total Sales</i>	78.84%	78.86%	78.93%	79.06%	79.26%	79.52%
Licensed stores	2,355.0	2,593.1	2,865.7	3,179.0	3,540.3	3,958.8
<i>% of Total Sales</i>	10.52%	10.63%	10.71%	10.75%	10.77%	10.76%
CPG, foodservice and other	2,381.1	2,565.2	2,773.8	3,009.8	3,276.8	3,579.0
<i>% of Total Sales</i>	10.64%	10.51%	10.36%	10.18%	9.97%	9.72%
Total net revenues	22,386.8	24,403.8	26,770.0	29,559.4	32,865.8	36,808.3
<i>% Increase</i>	5.02%	9.01%	9.70%	10.42%	11.19%	12.00%
Cost of sales (including occupancy costs)	9,038.2	9,830.6	10,777.0	11,898.4	13,232.1	14,825.3
<i>% Increase</i>	6.19%	8.77%	9.63%	10.41%	11.21%	12.04%
Gross Margin	13,348.6	14,573.2	15,993.1	17,661.0	19,633.7	21,982.9
<i>% Gross Margin</i>	59.63%	59.72%	59.74%	59.75%	59.74%	59.72%
Store operating expenses	- 6,493.3	- 6,966.4	- 7,575.1	- 8,289.8	- 9,139.5	- 10,156.6
Other operating expenses	- 553.8	- 608.4	- 666.7	- 736.2	- 822.4	- 926.8
Depreciation & Amortization expenses	- 1,011.4	- 1,391.9	- 1,315.5	- 1,414.6	- 1,528.9	- 1,661.1
General & Administrative expenses	- 1,393.3	- 1,715.8	- 1,917.6	- 2,151.5	- 2,423.6	- 2,741.2
Income from equity investees	391.4	423.8	461.7	505.9	557.4	617.5
Operating Result before Taxes (EBIT)	4,288.2	4,314.5	4,979.8	5,574.8	6,276.7	7,114.8
<i>% Increase</i>	2.79%	0.61%	15.42%	11.95%	12.59%	13.35%
<i>Operating Margin (EBIT Margin)</i>	19.16%	17.68%	18.60%	18.86%	19.10%	19.33%
EBITDA	5,299.6	5,706.4	6,295.3	6,989.4	7,805.6	8,775.9
<i>EBITDA Marge</i>	23.67%	23.38%	23.52%	23.65%	23.75%	23.84%
Taxes	1,368.6	1,432.2	1,653.2	1,850.8	2,084.0	2,362.4
<i>% Revenue</i>	6.11%	5.87%	6.18%	6.26%	6.34%	6.42%
Operating Income after tax	2,919.6	2,882.3	3,326.6	3,724.0	4,192.8	4,752.5
Total Other Comprehensive Income	- 47.2	- 26.4	- 26.4	- 26.4	- 26.4	- 26.4
Gain resulting from acquisition of JV	0	0	0	0	0	0
Litigation charge / credit	- 153.5	-	-	-	-	-
Net Operating Result after tax	2,718.9	2,855.9	3,300.3	3,697.6	4,166.4	4,726.1
Interest income and other, net	275.3	521.3	137.3	137.3	137.3	137.3
Interest expense	- 92.5	- 142.0	- 221.1	- 221.1	- 190.1	- 190.1
Loss on extinguishment of debt	-	-	-	-	-	-
Net Financial Result before Tax	182.8	379.4	83.8	83.8	52.8	52.8
Tax Shield	64.0	132.8	29.3	29.3	18.5	18.5
Net Financial Result after tax	118.8	246.6	54.4	54.4	34.3	34.3
Net Income	2,884.7	3,122.0	3,265.3	3,662.7	4,151.6	4,711.3
Comprehensive Result	2,837.7	3,102.5	3,245.8	3,643.2	4,132.1	4,691.8
<i>% of Revenue</i>	12.68%	12.71%	12.12%	12.32%	12.57%	12.75%

Consolidated Balance Sheet

Consolidated Balance Sheet (in USD mn)	2017	2018E	2019E	2020E	2021E	2022E
Operating Assets						
Working Cash	111.9		122.0	133.9	147.8	164.3
Equity and cost investments	481.6		501.5	522.1	543.7	566.1
PPE net	4,919.5		5,185.6	5,688.4	6,281.1	6,983.7
Deferred income taxes net	795.4		1,056.6	1,219.7	1,365.5	1,537.5
Other long-term assets	338.4		293.1	293.1	293.1	293.1
Other intangible assets	441.4		437.9	479.0	468.7	456.7
Goodwill	1,539.2		1,539.2	1,539.2	1,539.2	1,539.2
Accounts Receivable net	870.4		909.0	997.2	1,101.1	1,224.2
Inventories	1,364.0		1,605.5	1,760.1	1,943.2	2,161.1
Prepaid expenses and other current assets	344.7		400.3	464.9	540.0	627.1
Deferred income taxes net	-		-	-	-	-
Total Operating Assets	11,206.5		12,050.9	13,097.6	14,223.4	15,553.2
% Increase	1.90%		7.53%	8.69%	8.60%	9.35%
Operating Liabilities						
Other long-term liabilities	733.2		662.0	742.8	843.3	915.6
Accounts Payable	782.5		780.6	855.8	944.8	1,050.7
Accrued Liabilities	1,488.6		1,818.1	1,994.4	2,202.2	2,448.6
Insurance Reserves	215.2		224.4	231.4	233.1	229.9
Stored value card liability	1,288.5		1,616.4	1,910.9	2,262.1	2,654.7
Total Operating Liabilities	4,508.0		5,101.6	5,735.3	6,485.5	7,299.5
% Increase	2.88%		13.17%	12.42%	13.08%	12.55%
Net Operating Assets	6,698.5		6,949.3	7,362.3	7,737.9	8,253.7
% Increase	1.26%		3.74%	5.94%	5.10%	6.67%
Financial Assets						
Excess of Cash	2,350.4		1,566.2	1,848.0	312.0	1,557.5
Long-term investments	542.3		542.3	542.3	542.3	542.3
Other long-term assets	24.4		21.5	21.5	21.5	21.5
Short-term investments	228.6		123.9	123.9	123.9	123.9
Prepaid expenses from derivative assets	13.4		28.8	28.8	28.8	28.8
Total Financial Assets	3,159.1		2,282.7	2,564.5	1,028.5	2,273.9
% Increase	-5.20%		-27.74%	12.35%	-59.89%	121.09%
Financial Liabilities						
Long-term debt	3,932.6		4,932.6	7,132.6	7,132.6	6,132.6
Other long-term liabilities	22.1		22.1	22.1	22.1	22.1
Accrued Liabilities	16.4		16.4	16.4	16.4	16.4
Current Portion of Long-Term Debt	0		0	0	0	0
Total Financial Liabilities	3,971.1		4,971.1	7,171.1	7,171.1	6,171.1
% Increase	7.57%		25.18%	44.26%	0.00%	-13.94%
Total Liabilities	8,479.1		10,072.7	12,906.4	13,656.6	13,470.6
Net Financial Assets	-812.034		-2688.4	-4606.6	-6142.6	-3897.2
Non-Controlling Interests	6.9		6.9	6.9	6.9	6.9
Common Shareholder's Equity	5,879.6		4,254.0	2,748.8	1,588.4	4,349.7
						7,627.2

Statement of Cash Flows

Statement of Cash Flows (in USD mn)	2017	2018E	2019E	2020E	2021E	2022E
Net Operating Result	2,718.9	2,855.9	3,300.3	3,697.6	4,166.4	4,726.1
Investment in Net Working Capital						
Change in Working Cash	5.4	10.1	11.8	13.9	16.5	19.7
Change in Deferred Income Taxes	- 90.0	261.2	163.1	145.8	172.0	205.4
Change in Other Long-Term Assets	- 72.9	- 45.3	-	-	-	-
Change in Accounts Receivable	101.6	38.6	88.1	103.9	123.2	146.9
Change in Inventories	- 14.5	241.5	154.6	183.1	217.8	260.2
Change in Prepaid Expenses and other Current Assets	22.4	55.6	64.6	75.0	87.1	101.2
Change in Deferred Income Taxes	-	-	-	-	-	-
Change in Other Long-Term Liabilities	115.1	- 71.2	80.8	100.5	72.3	101.5
Change in Accounts Payable	51.9	- 1.9	75.1	89.0	105.9	126.5
Change in Accrued Liabilities	- 127.4	329.5	176.3	207.8	246.3	293.7
Change in Insurance Reserves	- 30.8	9.2	7.1	1.7	3.2	3.7
Change in Stored Card Value Liability	117.3	327.9	294.5	351.2	392.6	471.0
Total Change in Investments in Net Working Capital	174.1	31.7	151.6	228.3	197.2	263.0
Gross CAPEX						
Change in Equity and Cost Investment	127.1	19.9	20.7	21.5	22.4	23.4
Change in PPE	385.7	266.1	502.8	592.7	702.6	837.7
Change in Intangible Assets	- 74.9	- 3.5	41.1	- 10.4	- 11.9	3.8
Change in Goodwill	- 180.4	-	-	-	-	-
Total Change in Gross CAPEX	- 257.5	- 282.5	- 564.6	- 603.9	- 713.1	- 864.9
Total Investment	- 83.4	- 250.8	- 413.0	- 375.6	- 515.9	- 601.9
Free Cash Flow	2,635.5	2,605.1	2,887.2	3,322.1	3,650.5	4,124.2
Debt Financing						
Net Financial Result after Tax	118.8	246.6	- 54.4	- 54.4	- 34.3	- 34.3
Change in Excess of Cash	328.1	- 784.2	281.8	- 1,536.0	1,245.4	2,675.6
Change in Short Term Investments	94.2	- 104.7	-	-	-	-
Change in Long Term Investments	- 599.4	-	-	-	-	-
Change in Other Long Term Assets	18.0	- 2.9	-	-	-	-
Change in Prepaid Expenses fom Derivative Instrument:-	14.3	15.4	-	-	-	-
Change in Long-term debt	730.4	1,000.0	2,200.0	-	- 1,000.0	-
Change in Other long-term liabilities	- 49.5	-	-	-	-	-
Change in Accrued Liabilities (Derivatives Liabilities)	- 1.6	-	-	-	-	-
Change in Current Portion of Long-Term Debt	- 400.0	-	-	-	-	-
Debt Financing Cash Flow	571.5	2,123.0	1,863.7	1,481.5	- 2,279.7	- 2,709.9
Equity Financing Cash Flow	- 3,207.0	- 4,728.3	- 4,751.0	- 4,803.6	- 1,370.8	- 1,414.3
Financing Cash Flow	- 2,635.5	- 2,605.3	- 2,887.2	- 3,322.1	- 3,650.5	- 4,124.2

Statement of Changes in Equity

Statement of Changes in Equity (in USD mn)	2017	2018E	2019E	2020E	2021E	2022E
Beginning Balance	6,249.1	5,879.8	4,254.0	2,748.8	1,588.4	4,349.7
Transactions with Shareholders						
Stock-based compensation expense	177.9	186.4	186.7	180.4	170.6	168.8
Exercise of stock options / vesting of RSUs	117.0	54.6	29.5	19.2	62.3	107.1
Sale of common stock	28.7	30.8	32.9	35.2	37.4	39.6
Repurchase of common stock	- 2,079.1	- 3,267.3	- 3,337.8	- 3,409.9	-	1.0
Cash dividends declared	- 1,451.5	- 1,732.7	- 1,662.2	- 1,590.1	- 1,516.5	- 1,516.5
Total Transactions with Shareholders	- 3,207.0	- 4,728.3	- 4,751.0	- 4,803.6	- 1,370.8	- 1,414.3
Comprehensive Income						
Net Income (excluding Non-Controlling Interest)	2,884.9	3,128.9	3,272.2	3,669.6	4,158.5	4,718.2
Unrealized holding gains / losses on available for sale securities	- 6.6	- 0.4	- 0.4	- 0.4	- 0.4	- 0.4
Unrealized gains / losses on cash flow hedging instruments	40.6	5.6	5.6	5.6	5.6	5.6
Unrealized gains / losses on net investment hedging instruments	12.7	8.8	8.8	8.8	8.8	8.8
Translation Adjustment	- 40.7	- 44.8	- 44.8	- 44.8	- 44.8	- 44.8
Reclassification adjustment for net (gains) / losses realized in net	- 53.2	4.4	4.4	4.4	4.4	4.4
Total Other Comprehensive Income	- 47.2	- 26.4	- 26.4	- 26.4	- 26.4	- 26.4
Total Comprehensive Income	2,837.7	3,102.5	3,245.8	3,643.2	4,132.1	4,691.8
Ending Balance	5,879.8	4,254.0	2,748.8	1,588.4	4,349.7	7,627.2

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Report Recommendations

Buy	Expected total return (including expected capital gains and expected dividend yield) of more than 10% over a 12-month period.
Hold	Expected total return (including expected capital gains and expected dividend yield) between 0% and 10% over a 12-month period.
Sell	Expected negative total return (including expected capital gains and expected dividend yield) over a 12-month period.

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