EVERCORE ISI

Consumer | Restaurants

January 29, 2024

Starbucks Corporation

SBUX | $92.80

Outperform | Target Price/Base Case: $125.00

Earnings Preview

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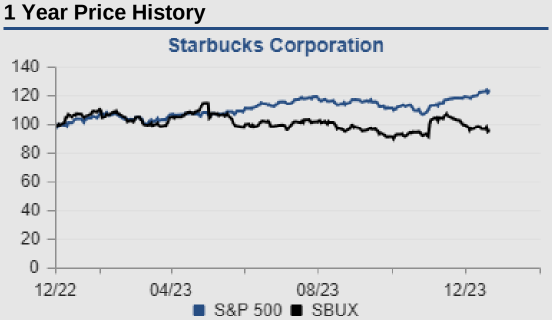
Company Statistics

52-Week Range	$89.48 - $114.56
Base Case	$125.00
Upside/Downside	30.7%
Market Capitalization (B)	$108
Forward P/E	23.0
Dividend Yield	2.2%
Short Interest	1.3%

Earnings Summary

		2023	2024E	2025E
Consensus EPS	Q1	$0.75	$0.96	..
	Q2	$0.74	$0.89	..
	Q3	$1.00	$1.12	..
	Q4	$1.06	$1.18	..
	FY	**$3.54**	**$4.13**	**$4.82**
EPS	Q1	$0.75	$0.99	..
	Q2	$0.74	$0.88	..
	Q3	$1.00	$1.08	..
	Q4	$1.06	$1.21	..
	FY	**$3.54**	**$4.16**	**$4.91**

1 Year Price History



Source: FactSet

A cold beverage growth story, Tims China lunch takeaways, and pre-F2Q thoughts

Heading into F1Q earnings (tomorrow after the close), we try to better explain what caused the presumed 5pp+ deceleration in Americas SSS growth in November, and why we think that SSS will likely trough in F2Q before reaccelerating in F2H. Additionally, see pages 2-3 for takeaways from our Tim Hortons China meeting last week.

Four factors that contributed to the slowdown. Our assumption Starbucks Americas SSS growth decelerated by ~mid-single digits in November, which was driven by a combination of **1)** rolling off a very successful hot beverage season in the fall, featuring the popular Pumpkin Spice Latte, which drove aspirational customers into the brand in F4Q (see Figure 2); **2)** a shift from warm weather months (including an unseasonably warm October) to cold weather months that proved to be a depressant to cold beverage demand (the key driver of Starbucks' SSS growth in recent years; see below bullet); **3)** consumer boycotts due to union activity and the Israel/Palestine conflict, which we think were a minor factor (see Figure 3); and **4)** a cautious consumer that also impacted discretionary areas of restaurants like casual dining (see Figures 1 and 2).

Trimming F2Q Americas SSS by 1pp as we anticipate continued warm quarter SSS growth outperformance. Our FY24 Americas SSS growth forecasts by quarter are: F1Q: 5% (cons. 5.5%), F2Q: 3% (previously 4%; cons. 4.5%), F3Q: 5% (cons. 5.5%), and F4Q 5% (cons. 5%). Cold beverage growth has become a key driver of outsized SSS growth in the warmer quarters (F3Q/F4Q) which have near 80% cold beverage mix (versus closer to 50% in winter months) — see Figure 2. Last summer, cold foam blenders bolstered cold beverage sales and we believe cold-pressed espresso could prove to be another boost to throughput and innovation in FY24.

We still see a path to ~15%+ EPS growth in FY25 and beyond… We are forecasting ~17% EPS growth over the next few years on average fueled by **a)** North America labor productivity fueled by new equipment in FY24 and Siren deployment in FY24–FY27, **b)** $600M of annual COGS savings over the next three years, **c)** $300M annual supply chain savings, **d)** increased innovation, **e)** expanded use of personalized/ digital marketing, and **f)** building momentum Internationally ex-China.

This reinforces our base case $125 price target and Outperform rating. Our $125 target is based on our DCF analysis and equates to 25x our FY25e EPS of $4.91 (+18% YoY; cons. $4.80). Today, SBUX trades at 22x our FY24e EPS or a P/E to total return ratio of 1.2x (assuming LT EPS growth of 16% and 2.5% dividend yield). Our target valuation is toward the low-end of Starbucks' 5-year average NTM P/E range of 24–29x. Our FY24 forecast incorporates 9.5% revenue growth with ~5% North America SSS growth (cons. 5.5%). EPS growth in FY24 is underpinned by 105bp of operating margin expansion to 17.2% (FY18/FY19 avg: 17.5%; cons. 17.0%) — still well below the peak of 19.7%.

See pages 2–4 for more details

Key points

No change in Americas operating margin assumptions

Using the F4Q North America operating margin run rate as a proxy for momentum and FY24 performance would point to upside to our forecast

Reiterating above consensus FY24 North America operating margin. For FY24, we are reiterating our Americas operating margin estimate of 22.0% (+120bp YoY; cons 21.6%) driven by **1)** positive pricing net of commodity inflation; **2)** lapping significant labor and wage increases; **3)** lapping training and support cost; **4)** sales leverage; and **5)** a step-up in productivity. We continue to expect US store throughput improvements, labor stability, seasonal factors helping cold beverage (75%+ of beverage mix), innovation, and loyalty (~90% larger than pre-COVID) to help support SSS growth in FY24 even as pricing benefit fades.

Reiterating FY24 US SSS growth of 5% (cons. +5.5%)

Some reasons for 5% SSS growth for FY24 as a whole:

- **Improving labor productivity:** There is a greater benefit from the Reinvention plan, which includes labor stability and increasing throughput with equipment upgrades. As of last quarter, there was an 10pp reduction in turnover YoY, an 5pp increase in the number of hours per barista, and an 16pp improvement in barista tenure. Productivity should continue to amplify with this still being the early stages of newly and re-trained partners.

Benefits from labor productivity improvements are still in early innings with equipment upgrades and eventually the "siren system" further enhancing efficiency

- **Equipment rollout benefit is beginning to ramp.** New equipment rollouts include Clover Vertica brewers (6% rolled out as of last quarter), new nugget ice dispenser (5% rolled out as of last quarter), which will continue to be rolled out through FY24. North America transactions per store are still 8% below pre-COVID levels with the morning daypart (until 10AM) above pre-COVID levels. We believe there continues to be demand that cannot be serviced in the AM, which should improve with further equipment rollouts in FY24 such as cold press espresso and a refresher dispenser. This is leading to higher capex in FY24 and FY25, with our model incorporating $3.0B in FY24 (cons. $2.9B) and $3.0B in FY25 (cons. $3.0B).
- **Growth beyond pricing:** Two-thirds of Starbucks SSS growth is coming from transactions, mix, attach, and customization. Demand continues for more premium beverages, which has created a new normal as it relates to mix and customization. Starbucks has been leaning on this demand with innovation such as the Iced Pumpkin Cream Chai Tea Latte and Pumpkin Cream Cold Foam. Additionally, food attach continues to grow with food sales approaching $6B in FY24.
- **Rewards growth:** We expect Starbucks to use digital marketing to leverage its larger Rewards membership to the benefit of frequency. Starbucks Rewards membership is ~90% larger than pre-COVID levels which stands in contrast to traffic down mid- to high-single digits. Rewards customers are highly engaged with 43% of transactions from Reward members and 29% mobile order transactions mix.
- **Extended "Siren System" rollout.** The "Siren System" is expected to be less than 10% rolled out in FY24, 40% rolled out by FY26, and we would expect the balance to be rolled out in FY26/FY27. That means that FY27, or even FY28 may be the first year with full "Siren System" benefits. These changes should be additional unlocks to throughput and transaction growth. Although the installations will be a net-net headwind to margin, we do not think it will be a significant disruption to overall segment operating margin given the gradual rollout.

Takeaways from our meeting with Tim Hortons China

We recently hosted a meeting with executives from Tim Hortons China including Yongchen Lu (CEO) to discuss the company's growth plans in Coffee and Chicken in China.

Very early signs of a more rational pricing environment

Minimal profitability from 8-10 RMB coffee in China could cause unit closures and fewer new unit openings from more value based players

One of our key takeaways from the meeting was that the coffee discounting war in China — largely started by Cotti Coffee — is showing early signs of improvement, but a notably more rational environment could take time. Cotti entered the market and began selling a cup of coffee for 9.9 RMB, which caused Luckin to lower its prices from RMB 15 to the 8-10 RMB range. We believe this has caused other coffee players in the country to promote to protect traffic share, including Starbucks (using digital coupons to buy one get one 50% off). Tims China 19.9 RMB combo offering including a bagel with a coffee continues to be a strong value proposition to its customers (55% of Tims China orders come with food).

We believe that tightening capital markets in China with a greater emphasis on profitability will mean fewer coffee store openings from other players. Notably, many Cotti franchisees are unprofitable selling coffee for less than RMB 10, which could cause some unit closures. We would note that Tims China continues to have very strong demand for franchise opportunities given better store-level profitability than competitors.

The majority of Tims China go-forward growth will be sub-franchised and smaller format

Tims China initially invested in larger store formats when entering the market to help build up customer awareness of the brand. However, now that the brand is approaching 1,000 units in the market, we would expect the majority of new units to be smaller formats and sub-franchised. This will mean faster cash-on-cash returns with less capex to open stores (for company-owned units) and less labor, while a higher mix of franchised openings will free up even more capital. The company remains confident that it reach its goal of 2,750 Tims units by 2026, with Popeyes openings being on top of that target.

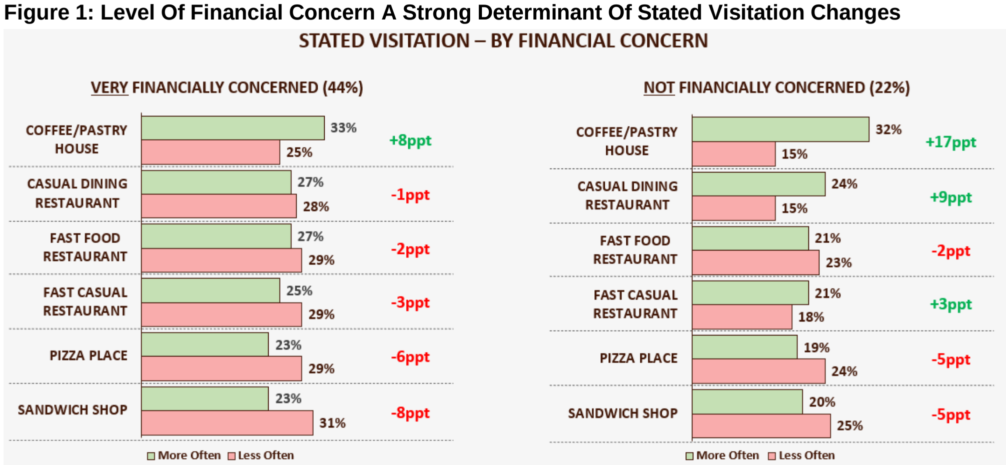
Read-throughs for Starbucks China

Our F2Q-F4Q China SSS growth forecasts of 3% (cons. 4% on average) are below consensus but still positive

The near-term COVID recovery may not be as strong as once hoped, and Starbucks' heavier reliance on tourism and travel spending and premium prices could cause its growth to trail peers. However, we continue to believe in **1)** new store growth opportunities (13% growth in China and ~11% FY24/FY25 net new store growth internationally; cons. +11%), **2)** a recovery in International segment operating margin (+30bp in FY24 and +160bp in FY25; cons. +140bp and +60bp, respectively), and **3)** positive, but below guidance F2Q-F4Q SSS growth. Evercore ISI China SSS growth forecasts by quarter: F1Q: 11% (cons. 17%); F2Q: 3% (cons. 5%), F3Q: 3% (cons. 4%), F4Q: 3% (cons. 4%).

When consumers are financially concerned, they tend to cut back casual dining and coffee shop visits relatively more

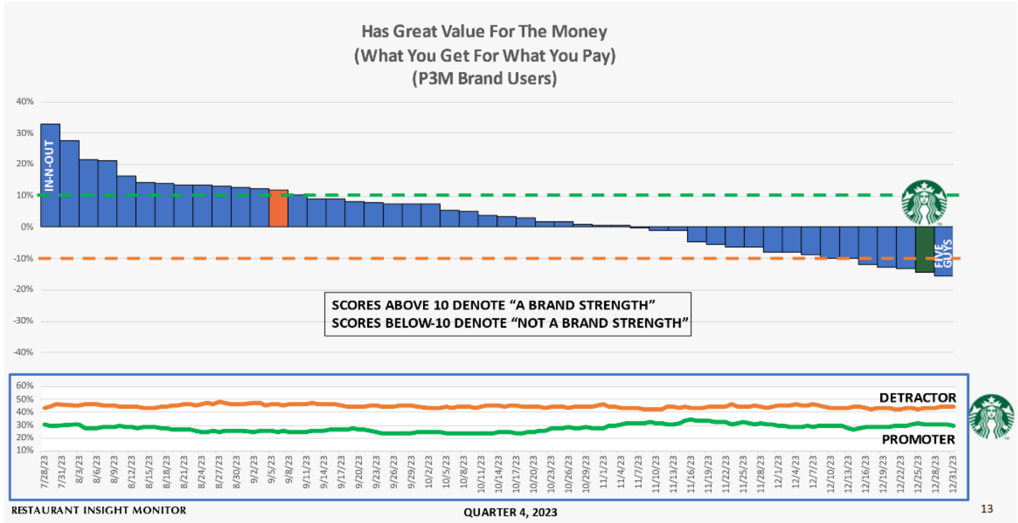
Figure 1: Level Of Financial Concern A Strong Determinant Of Stated Visitation Changes



Source: Restaurant Finance Monitor, Evercore ISI

Starbucks is towards the bottom of surveyed restaurants brands when it comes to value for money

Figure 2: Value perception is not an asset for Starbucks



Source: Evercore ISI, Restaurant Insight Monitor

Our data says that boycotts are not one of the top reasons customers are visiting Starbucks less

Figure 3: Starbucks Boycott Effect

Has There Been A Boycott Effect?

Among Starbucks customers who indicate that they are visiting Starbucks *less often*, we asked them:

"What is the PRIMARY reason that you are ACTIVELY CHOOSING to visit Starbucks LESS OFTEN?"

The overwhelming reason given by is an economic one

1. Starbucks prices have gotten too high
   "The primary reason I have actively chosen to visit Starbucks less often is because of the increase of price"
2. Economy is forcing them to cut back
   "Can't afford it because the price of everything has gone up"

Reasons related to a boycott are extremely nominal

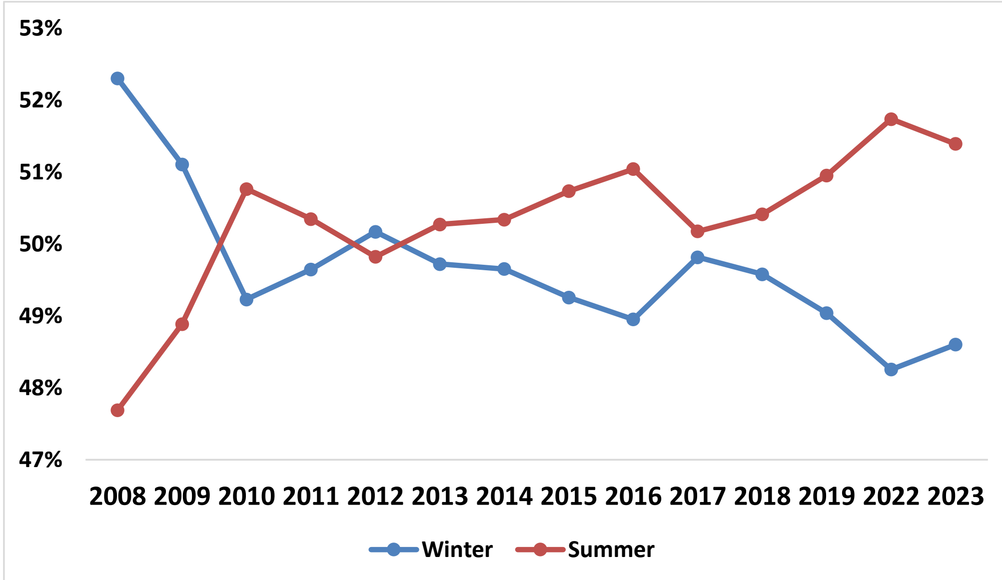
PRIMARY REASON CHOOSING TO GO TO STARBUCKS LESS OFTEN	
Cost / Too expensive / Price increases	42%
Effects of economy / Budgeting	24%
Making coffee at home instead	7%
Boycott / Israel	6%
Misc (e.g., location closed, cutting back on coffee, etc.)	22%

RESTAURANT INSIGHT MONITOR QUARTER 4, 2023 21

Source: Evercore ISI, Restaurant Insight Monitor

Cold beverage season can be evidenced by the fact that historically F1Q and F2Q (winter) was close to 52% of annual sales, but this has swapped in recent years with summer now having the seasonally higher sales

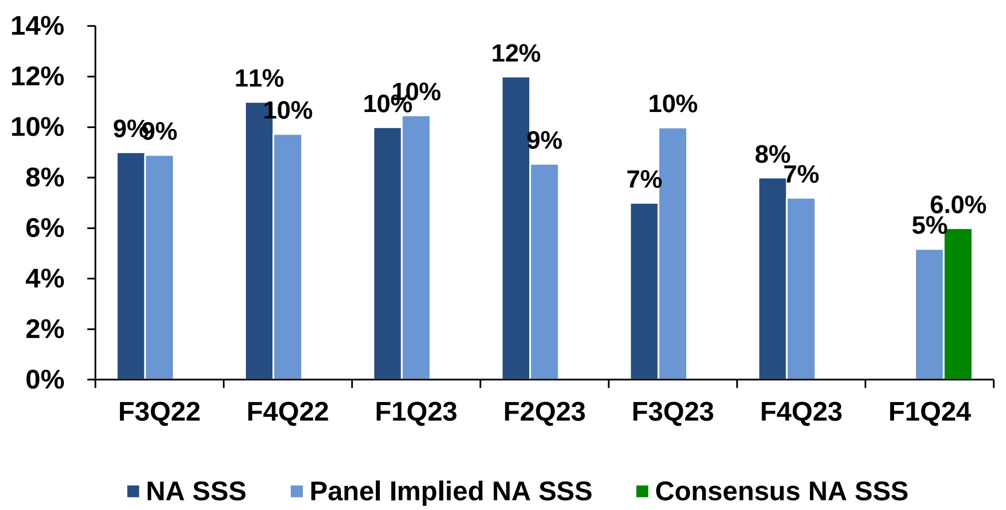
Figure 4: Domestic seasonality (summer = F3Q/F4Q; winter = F1Q/F2Q)



Source: Evercore ISI, Company Reports

Our panel data points to a 6% Americas SSS growth result, but it has not been as accurate as our DPZ panel

Figure 5: SBUX panel analysis



Source: Evercore ISI

Figure 6: SBUX Placer AI

	4Q21	1Q22	2Q22	3Q22	4Q22	1Q23	2Q23	3Q23	4Q23		1Q24	1Q24
Starbucks placer traffic growth	28%	28%	16%	2%	-2%	-4%	9%	3%	4%	Placer	-5%	-18%
Starbucks actual transaction growth	19%	12%	5%	1%	1%	1%	6%	1%	2%	EVRe	0%	2%
										Cons	1%	1%

Source: Evercore ISI, Placer AI

Weaker debit card data from Starbucks in F1Q supports our below consensus NA SSS growth forecast of 5% (cons. 5.5%)

Figure 7: SBUX Bloomberg debit card data

	2Q22	3Q22	4Q22	1Q23	2Q23	2Q23	3Q23	4Q23		1Q24	QTD
Implied SSS	3%	-4%	5%	7%	9%	16%	-1%	9%	Implied	5%	0%
Actual SSS	6%	7%	8%	10%	9%	6%	7%	8%	EVRe	5%	4%
									Cons	6%	5%

Source: Evercore ISI, Bloomberg

VALUATION METHODOLOGY

Our $125 base case price target is based on our DCF analysis and equates to ~29x (5 year NTM P/E range 24-29x) our CY24 EPS. Although this is at the high-end of the historical range, we would argue that this CY24 estimate is still "under-earning" and that EPS growth in FY25 and FY26 will be elevated.

RISKS

Input cost inflation: The company may come under margin pressure should key input costs rise and the company is unable to pass these costs on through price. Input costs may include food commodities as well as labor. Restaurant margins would compress in a highly inflationary input cost environment.

Macroeconomic risk: Slowing economic activity and decreased consumer spending could adversely impact restaurant spending. Should there be a major downturn or a recession, the highly discretionary and cyclicality nature of the restaurant industry could hurt spending and profitability.

Food safety and quality: As with every independent restaurant or restaurant chain, reputation is vital. Food safety and quality are important to uphold, and any instance of an illness or outbreak coming from the company's restaurants could adversely affect brand perception.

Foreign currency risk: With stores outside of the US, the company is at risk of fluctuations of the US dollar. Currencies move may adversely affect the earnings power of the company in US dollar terms.

Highly competitive restaurant industry: Changes in promotional activities may cause market share shifts, and restaurant substitutions have little to no switching cost for consumers. Specifically, pressure from discounted peers such as McDonald's in the US and Luckin in China may slow global growth. Maintaining Starbucks' brand image and reputation are crucial for the chain to justify its premium price points.

COMPANIES UNDER COVERAGE BY AUTHOR

Symbol	Company	Rating	Price (2024-28-01)	Evercore ISI Target
BGS	B&G Foods	In Line	$10.32	$12.00
BRBR	BellRing Brands, Inc.	Outperform	$55.46	$57.00
CAG	Conagra Brands	In Line	$29.62	$32.00
CMG	Chipotle Mexican Grill, Inc	Outperform	$2326.25	$2600.00
DPZ	Domino's Pizza, Inc	Outperform	$419.12	$450.00
DRI	Darden Restaurants, Inc.	In Line	$160.99	$170.00
EAT	Brinker International, Inc.	In Line	$39.41	$46.00
GIS	General Mills	In Line	$64.51	$72.00
HAIN	Hain Celestial	In Line	$10.95	$13.00
HSY	Hershey	In Line	$190.21	$210.00
K	Kellanova	In Line	$54.74	$62.00
KHC	Kraft Heinz	Outperform	$37.21	$42.00
KLG	WK Kellogg Co	In Line	$13.69	$15.50
MCD	McDonald's Corp	Outperform	$292.26	$330.00
MDLZ	Mondelez International	Outperform	$75.14	$80.00
POST	Post Holdings	Outperform	$92.79	$108.00
QSR	Restaurant Brands International	Outperform	$76.88	$88.00
SBUX	Starbucks Corporation	Outperform	$92.80	$125.00
TWNK	Hostess Brands	In Line	$33.30	$34.00
TXRH	Texas Roadhouse, Inc.	Outperform	$122.82	$135.00
WEN	Wendy's Company	In Line	$19.18	$23.00
YUM	Yum! Brands, Inc	Outperform	$129.09	$160.00

TIMESTAMP

(Article 3(1)e and Article 7 of MAR)

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*Prior to October 10, 2015, the "Coverage Suspended" and "Rating Suspended" categories were included in the category "Suspended."

FINRA requires that members who use a ratings system with terms other than "Buy," "Hold/Neutral" and "Sell" to equate their own ratings to these categories. For this purpose, and in the Evercore ISI ratings distribution below, our Outperform, In Line, and Underperform ratings can be equated to Buy, Hold and Sell, respectively.

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Coverage Universe			**Investment Banking Services I Past 12 Months**		
Ratings	**Count**	**Pct.**	**Ratings**	**Count**	**Pct.**
Buy	425	56	Buy	57	13
Hold	295	39	Hold	21	7
Sell	16	2	Sell	0	0
Coverage Suspended	23	3	Coverage Suspended	7	30
Rating Suspended	6	1	Rating Suspended	1	17

Issuer-Specific Disclosures (as of January 28, 2024)

Price Charts

Ratings Key

B	Buy	OP	Outperform	L	Long	CS	Coverage Suspended
H	Hold	IL	In Line	NP	No Position	RS	Rating Suspended
S	Sell	UP	Underperform	S	Short		

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