

COMPANY PROFILE

Starbucks Corporation

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COMPANY OVERVIEW

Starbucks Corporation (Starbucks or "the company") is a premier roaster, marketer and retailer of specialty coffee. The company operates in over 55 countries across North America, Asia Pacific, the Europe Middle East Africa (EMEA) region, and Latin America. Starbucks is headquartered in Seattle, Washington and employs 149,000 people.

The company recorded revenues of \$11,700.4 million during the financial year ended October 2011 (FY2011), an increase of 9.3% over FY2010. The increase in net revenues was due to an increase in company-operated retail revenues during the year. The operating profit of the company was \$1,728.5 million in FY2011, an increase of 21.8% over FY2010. The net profit was \$1,245.7 million in FY2011, an increase of 31.7% over FY2010.

KEY FACTS

Head Office	Starbucks Corporation 2401 Utah Avenue South Seattle Washington 98134 USA
Phone	1 206 447 1575
Fax	
Web Address	http://www.starbucks.com/
Revenue / turnover (USD Mn)	11,700.4
Financial Year End	September
Employees	149,000
NASDAQ Global Select Ticker	SBUX

SWOT ANALYSIS

Starbucks Corporation (Starbucks or "the company") is a premier roaster, marketer and retailer of specialty coffee. By investing in enhancing the in-store experience and offering value-added services, the company is building strong customer connect. However, challenges related to declining raw materials in future could affect the company's product quality, production costs and overall profit margins in future.

Strengths	Weaknesses
<ul style="list-style-type: none"> Building strong customer connect through value-added services Leveraging technology to build a robust distribution channel strategy Consistently strong financial and operating performance 	<ul style="list-style-type: none"> Weakening potential in the US Product recalls adversely affect brand image
Opportunities	Threats
<ul style="list-style-type: none"> Entry into the health and wellness space Growing presence in key Asian markets Expanding presence in the growing single-serve coffee market in the US The growing office coffee marketplace 	<ul style="list-style-type: none"> Lower supply of raw materials in the near future and rising prices may increase company's costs Introduction of Verismo machines could impact the company's in-store traffic and additional food sales

Strengths

Building strong customer connect through value-added services

Starbucks operates in the highly competitive foodservice retail space that demands consistent delivery of quality service to either retain existing customers or to attract new ones. Apart from selling its world-renowned coffee blends in a variety of flavors, the company is focused on providing a coffee-drinking experience to its in-store customers. In the past several years, the company has been focusing on meeting its customers' unstated demands by offering various value-added services such as, entertainment on premises.

Starbucks offers free, instant and unlimited Wi-Fi connectivity at all its company-owned stores across the US and Canada. Customers, who come for a drink or a snack, are encouraged to spend more time inside the store through free access to internet and the Starbucks Digital Network – a news and entertainment web portal offered in association with Yahoo.com. The Starbucks Digital Network

also offers free access to subscription editions of various premium news resources, such as The Wall Street Journal, New York Times, USA Today, The Economist, and ESPN Insider. It also offers exclusive iTunes downloads and e-book downloads for its in-store customers. Apart from these in-store experiences, the company also targets customers by up-selling merchandise including music, movies, apparel, books and accessories.

While the company's strategy is to build stronger customer connect, through these initiatives it is also able to gain a higher footfall with customers walking in for the exclusive in-store experiences. Additionally, Starbucks is able to create a unique selling proposition by combining its customized coffee blends with in-store experiences that customers look forward to. All these strategies are aiding the company in building its competitive advantage.

Leveraging technology to build a robust distribution channel strategy

While operating in the vast food service space, Starbucks is required to build a robust distribution strategy to stay ahead of its competition. In terms of distribution, the company sells through four channels: company-operated retail stores, licensed stores, consumer packaged goods and foodservice operations. In the recent times, the company has been expanding its distribution network to include as many channels to reach customers where they work, travel, shop and dine.

Aside from the traditional distribution channels, the company has opened various more avenues to reach its customers through internet and mobile applications. For instance, in January 2011, Starbucks launched its mobile payment application at all of its 6,800 company owned stores and 1,000 stores operated by Target in the US market. This application allows customers to pay for their in-store purchases through select smartphones. The Starbucks Card Mobile App displays a barcode that can be used just like a Starbucks Card to make a purchase. To pay, customers need to hold the mobile device in front of a scanner on the countertop and scan the Starbucks Card Mobile App's on-screen barcode to make a purchase. The application also allows customers to track rewards and reload balance using PayPal. The program was tested at select stores in 2009. After extensive testing, it was found to be an efficient and quick way to process payments at the company's stores. More than 3 million customers have used Starbucks mobile payment application since its launch. According to Starbucks, there is a demand for such a type of payment service. Over one third of its customers use a smartphone and one in five uses a Starbucks card at checkout.

Later, in June 2011, the company launched Starbucks for iPhone, a mobile application that introduces its popular Starbucks Card eGift feature on a mobile device and also combines the features of its two popular applications for iPhone and iPod touch – myStarbucks and Starbucks Card Mobile. Through this new application, the company allows its customers to access their favorite Starbucks Card features, use the mobile payment capability and track their My Starbucks Rewards and custom Starbucks features in a single application. The new application also allows customers to send a mobile gift. In the same month, the company also launched a similar mobile application for Android-based smartphones, Starbucks for Android application. The Android application provides consumers access to the fastest way to pay and other features to manage their Starbucks Card on-the-go. Following the success of these mobile applications, Safeway, the US-based retail

supermarket chain, in July 2011, announced plans to rollout mobile payment at nearly 1,000 Starbucks in Safeway supermarkets across the US.

By leveraging technology, the company is not just reaching out to an expanding base of consumers, but also is offering them a more convenient way of making transactions. Furthermore, these strategic initiatives will allow Starbucks to break through its traditional distribution channels, increase the addressable market and add new avenues for revenue generation.

Consistently strong financial and operating performance

Despite a sluggish economy, the company has achieved strong financial results in the past five years. During 2007–11, the company's net revenues increased at a Compounded Annual Growth Rate (CAGR) of 6%. The operating profit grew at a CAGR of 13% and the net profit grew at a CAGR of 17% over the same period of five years. During these five years, although there were significant store closures in the company's US market due to slackening economic conditions, this was offset by new store openings in its international markets during the period. During FY2011, strong global comparable stores sales growth of 8% essentially drove increased sales leverage and resulted in higher operating margins and net earnings for the company. Additionally, the operating performance was also aided by strong growth in global same store sales in Asia-Pacific, where the same store sales grew by 22% in FY2011, as compared to a 2% in FY2009.

Despite significant headwinds from commodity costs and a challenging consumer environment in the wake of a weak economy, the company's strong operating performance aided by appropriate global expansion is helping it sustain its strong market position.

Weaknesses

Weakening potential in the US

During FY2011, the company's US operating segment accounted for nearly 68.7% of total net revenues. While the total net revenues of the US operating segment increased by 6.3% in FY2011, the international operating segment revenues increased almost two-fold by 14.7% during the same period. Also, while the store operating expenses for the US operating segment were 36% of the net revenues, for the international operating segment, the store operating expenses were significantly lower at 29.5% of the net revenues generated from this segment.

Furthermore, during FY2010 and FY2011, the company had closed 70 and 51 company-operated stores, respectively, in the US. Additionally, in FY2011, the company also reported the closure of 475 licensed Seattle's Best Coffee locations in Borders Bookstores due to the impairment of certain assets in Seattle's Best Coffee business associated with the Borders bankruptcy in April 2011.

In FY2011, the US accounted for nearly 77% of total net revenues. While the total net revenues increased by 7.6% in the US, the international sales increased almost two-fold by 15.2% during the

same period. The US being a large market and a large contributor to the company's overall revenues, the weakening operational performance and significant store closures in the recent past could pull down the company's overall profitability in the near to mid-term.

Product recalls adversely affect brand image

Starbucks has been registering increasing instances of product recalls lately. In July 2011, the US Department of Agriculture's Food Safety and Inspection Service reported finding *Listeria* bacteria in samples taken from chicken to be used in one of Starbucks' bistro box line of ready-to-eat meals. Following the report, FSIS and Flying Food Group, suppliers to Starbucks, recalled all Starbucks Chipotle Chicken Wraps and Starbucks Chicken & Hummus boxed meals produced in that month. A week later, FSIS and Flying Food expanded the recall to include two more contaminated products – Starbucks Salami and Cheese and Starbucks Chicken Lettuce Wraps.

Earlier in January 2010, the company recalled 11,000 and 1,200 units of glass water bottles supplied in the US and Canada, respectively. The recall was initiated after it was found that the bottle could shatter while removing or inserting its stopper, posing a laceration hazard to consumers. Previously, in FY2009, the US Consumer Product Safety Commission ordered recall of 530,000 units of Starbucks Barista Blade Grinders and Seattle's Best Coffee Blade Grinders. The recall was prompted as the company's grinders could fail to turn off or could turn on unexpectedly, posing a laceration hazard to consumers. Previously, Starbucks had recalled few of its products containing peanut butter from its stores following an outbreak of salmonella in the US. Product recalls could affect the value of the Starbucks brand and result in a decline in demand for its products.

Opportunities

Entry into the health and wellness space

According to the latest consumer survey conducted by Datamonitor in 2010, nearly 40% of Americans indicated a high preference for natural ingredients in their choice of soft drinks, including juices, carbonated beverages, nectars etc. The survey findings also revealed that nearly 38% of the respondents preferred food and beverages with no artificial additives, including colors, flavorings and preservatives. This high preference for healthier options is driven by a growing health consciousness among Americans. The US health food market is estimated to be worth approximately \$50 billion. Several food and beverage companies like PepsiCo, Coca-Cola and McDonald's have already entered the health and wellness space to leverage this new and fast expanding market.

In March 2012, Starbucks also entered the US health food market with the opening of its first Evolution Fresh store in Washington. Since acquiring the Evolution Fresh brand in November 2011, Starbucks expanded the brand's distribution to additional grocery channels and plans to expand it further in its company-owned retail stores in 2012. The new juice bar would also sell bottled Evolution Fresh fruit and vegetable juices, smoothies and food, such as oatmeal, wraps, salads and soups. The menu will also include vegan and vegetarian options and much-in-demand super foods like kale and quinoa.

In order to create a truly captivating experience, the company has designed the store to reflect a new look and feel that resonates the pure, natural ingredients in each beverage. The store also has a unique, patent-pending interactive juice wall that displays educational and entertaining digital illustrations of juices and smoothies being handcrafted. The company claims that each beverage is prepared using a Heat-free, High-pressure Pasteurization (HHP) process that retains more of the nutrients in the juice, compared with the conventional heat pasteurization used by some rivals in the refrigerated juice category.

Despite being the latest entrant into this high-growth health and nutrition space, the company's unique selling propositions like the HHP process and unique store experiences can help it achieve an edge over its competitors. Additionally, the new portfolio of healthy beverages will complement the existing revenue channels of the company and provide it additional income sources in future.

Growing presence in key Asian markets

Starbucks has been aggressively expanding its presence in Asia, particularly in China and India. The fast pace economic development in China coupled with the rise of the middle class income group and their increasing disposable income have contributed to the increase in demand for various consumer goods in the country. More than 160 cities in China have population greater than one million. Furthermore, the middle class population in China is expected to double by 2025. These factors are expected to lend support to the growing demand for consumer products offered by Starbucks. In order to tap this growing market, Starbucks has already embarked on aggressive expansion plans in the country. As per the company's latest reports, total count of stores in China and Asia Pacific reached 2,961 in the first quarter of FY2012. In the meanwhile, growth in same store sales in the region increased by 22% in FY2011 as compared to 2% during FY2009. The company's strategy for China, its key geographic focus for the mid-term future, is to increase the total number of stores to 1,500 by 2015 (compared to 361 in FY2009). Furthermore, China is expected to represent 32% of the company's total international unit openings during FY2011 to FY2015. Starbucks has been registering strong comparable store sales in China.

Besides China, the company is also focused on the high-potential Indian coffee retail market. The Indian market primarily consists of tea drinkers. However, the changing demographic and the country's rising middle class population are contributing significantly to the rise in coffee consumption. According to the Tea Board and Coffee Board of India, Indians consumed around 700,000 tonnes of tea in 2010 compared to 75,000 tonnes of coffee. This is indicative of the largely untapped market potential for coffee in the country. In January 2012, the company entered into a strategic partnership with Tata Global Beverages Limited of India on a 50/50 joint venture, named TATA Starbucks Limited. Under the new JV, Tata Global Beverages will own and operate Starbucks cafes in various cities across India and will be branded as Starbucks Coffee "A Tata Alliance." Aside from this, the company also signed a separate sourcing and roasting agreement with Tata Coffee Limited, according to which Tata Coffee Limited will roast coffee to supply TATA Starbucks Limited, and export to Starbucks Coffee Company. Several food chains and close competitors of Starbucks intend to tap the fast-growing Indian market, while restaurant chains like McDonald's and Yum! Brands already have considerable coverage in India.

By leveraging its strong brand name and business alliances with local players, Starbucks can expand the company's presence in fast growing Asian markets and lend stability to its topline growth.

Expanding presence in the growing single-serve coffee market in the US

Starbucks has been expanding its CPG business in the fast growing single-serve coffee market in the US. According to industry experts, the growth of the coffee market in the US in 2010 was primarily driven by sales of single-cup coffee which totaled nearly \$2 billion. Though the single-serve coffee comes at a higher cost, its popularity is on the rise. According to experts, it may appeal to people between the age group of 18 to 24 years setting up their first homes and older consumers with limited living space because of the convenience and variety it offers.

Starbucks entered the single-cup segment in the US with the launch of VIA Ready Brew in 2009. The product was subsequently launched in international markets, including Canada, the UK, Japan and the Philippines. The company also introduced new variants under the Starbucks VIA Ready Brew product line. As of August 2010, Starbucks VIA Ready Brew was distributed through more than 37,000 points of distribution in the US, including Starbucks stores; food, drug and mass merchandiser stores; foodservice accounts; and through e-commerce. The company has been pursuing opportunities to penetrate into the single-serve coffee market in the US. In February 2011, the company entered into an agreement with Courtesy Products to offer Starbucks ground coffees for use in the latter's patented C1 in-room and on-demand brewed coffee systems. Courtesy Products is one of the leading providers of in-room coffee service to hotels in the US. Under the agreement, Starbucks ground coffees would be made available in approximately 500,000 luxury and premium hotel rooms across the US that are being served by Courtesy Products.

In March 2011, Starbucks entered into a strategic alliance with Green Mountain Coffee Roasters for manufacturing, marketing, distributing and sale of Starbucks and Tazo Tea branded K-Cup portion pack for use in GMCR's Keurig Single-Cup brewing system. Starbucks is the exclusive, licensed super-premium coffee brand to be produced by GMCR for its Keurig single-cup brewing system. Starbucks' K-Cup portion packs were made available at food, drug, mass, club, specialty and department store retailers in the US and Canada. Furthermore, in a forward integration initiative, Starbucks introduced the Verismo single-serve brewer machine in March 2012. Through its own product, the company stated its intention to carve out a niche that Green Mountain and Nestle have successfully occupied for the past few years in the US market. With each of its product lines in this segment, Starbucks aims to target customers with different choices; Via Ready Brew is for those who don't want to buy a coffee machine; K-cups are for those who want a basic brewed coffee; and Verismo for more sophisticated coffee drinkers.

Through strategic alliances with GMCR and Courtesy Products, Starbucks could tap the growing demand for single-serve coffee in the US and broaden its customer base.

The growing office coffee marketplace

Starbucks has a significant presence in the office coffee marketplace, where it offers a whole array of products and solutions to corporate offices, commercial spaces and government buildings. During

2011, the company's premium coffee brand, Seattle's Best Coffee, reported a double-digit growth in the office coffee marketplace. This growth was especially significant considering that the company's growth in the space counters the market trend. As per the latest industry estimates, the office coffee services segment declined in volume by 2.5% over 2010–11, while Seattle's Best Coffee increased in volume by more than 12% during the same period.

As per a consumer survey done by the National Automatic Merchandising Association, nearly 60% of all employed coffee drinkers consider free coffee an employee benefit. Another related research also shows that among the 55% percent of adults who drink coffee every day, 34% prefer a premium coffee. This implies that for most employees who find a limited choice of either mediocre coffee or no coffee, a premium beverage like Seattle's Best Coffee represents an extra perk. Seattle's Best Coffee currently has a presence in nearly 50,000 locations including cafes, college campuses, restaurants, hotels, airlines, cruise ships and movie theatres. The company further intends to expand its presence in this space. The company reiterates that a brand like Seattle's Best Coffee could win in the workplace because the premium coffee brand is an easy and affordable way for companies to deliver an extra perk to employees.

Threats

Lower supply of raw materials in the near future and rising prices may increase company's costs

The company utilizes the premium Arabica beans, sourced from Brazil, for most of its coffee products. During 2011, abnormally heavy rainfall in Colombia, one of the largest coffee-producing nations, has damaged crops of the mild Arabica beans. Brazil, another large producer of the gourmet beans, had a disappointing harvest during the year. According to the latest industry estimates, production of the Arabica beans in Brazil, the world's biggest coffee grower, is expected to decline by 7% during 2012. Another market estimate reports that output of the Arabica beans in Brazil will be 39 million bags in 2012–13, down from 42 million bags in 2010–11. Both these incidents caused the global coffee prices to increase to a record level in 14 years during 2011.

With conditions like bad crop and low supply of its most-used coffee beans, Starbucks could face a challenge in meeting the desired quality standards. Additionally, with increasing raw material prices, the company could go through a cycle of decreased operating margins in the near future.

Introduction of Verismo machines could impact the company's in-store traffic and additional food sales

Starbucks introduced the first at-home premium single cup machine, Verismo system by Starbucks, to its US consumers in March 2012. Through the new Verismo system, Starbucks intends to offer Starbucks-quality espresso beverages, such as espresso, cappuccino and latte beverages at home. The company views this as a lucrative opportunity considering very low penetration volumes of an at-home single serve brewer in the US, compared to that in other developed European markets.

However, the success of this new product could be counter-productive to the company in terms of lowering its store footfalls.

Once consumers realize that they can brew the same quality coffees and other Starbucks-exclusive blends at home, they may prefer not to visit a store and thus, avoid the wait-time. If customers find the Verismo quality to be equivalent to that of the in-store brewed coffee, they could as well avoid paying a premium for the company's in-store coffees. Additionally, the company might also lose out on the additional sales from accompanying snacks/ meals it would make out of an in-store customer compared to a Verismo customer, who would only purchase refills from the store.

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