Financial Analysis of *Starbucks Corporation*

By Axel Touri, Lucas Sanchez, Théophile Toudon and Hugo Torché

Introduction

Starbucks is the world largest chain of coffee shops, where it sells its own coffee brand, tea, pastries and coffee machines. Founded in 1971 in Seattle, the company was bought in 1987 by Howard Schultz with the willing of establishing a certain coffeehouse culture through espresso bars as he has seen in Italy. Starbucks also started to spread by opening new stores this same year. However, the coffee chain waits 1992 to go public (165 stores) and began its expansion outside of America between the end of the 1990s and the beginning of the XXI century, until it reached in 2012 17,000 stores in 50 countries, approximately 160,000 employees worldwide including 120,000 in the US only.

The firm generates revenues through company-operated stores, licensed stores, “consumer packaged goods” (CPG) and foodservice operations.

Starbucks has known a constant rise until the subprimes crisis which curbed its progression for a couple of years. Instead of limiting their coffee consumption, consumers had changed their habits and switched from an out-of-home consumption to a home consumption, or bought cheaper brands. It leaded to a sales’ decline in the specialty coffee sector at the end of 2008.

However, since this crisis affected food sales less than non-food sales, the coffee market has not known a significant impact because of the important consumption of this stable product (except in producer countries). There still was a stable demand and a relatively weak supply.

That way, Starbucks registered a relevant growth from 2010.

As a coffee producer, there are several direct Starbucks competitors, the main ones being Costa Coffee and McDonald's McCafé. But Costa Coffee is probably the only company with Starbucks that exclusively deals and promotes its coffee. But indirect competitors like bakeries, tea producers and independent fast-food chains are still noticeable within the market.

Companies in this industry compete on the basis of quality, convenience, service and price. The coffee culture is still blossoming in many developing nations, there is a lot of competition between local and national contestants. Thus, Starbucks does not have leadership positions in all channels and markets.

Those firms don’t settle the same type of marketing strategy in order to claim a certain policy with their customers. Starbucks focuses on geographic and demographic segmentation strategy, whereas Costa Coffee uses targeting strategy, helping it in catering to the needs of the customers and introducing new products.

Starbucks can rely on two competitive advantages, which are of course a worldwide presence, but also a backwards supply chain integration. As already mentioned, its presence allow the firm to offer its products through company-owned and licensed stores and to sell a variety of its trademarked coffee & tea products through grocery and supermarkets chains around the world.

I. Value creation

Starbucks is creating value mainly with their own stores. Currently, 79% of their revenues are coming from them. This part of their activity is the stable part on which they can rely on with its consistent growth (see below). CPG, food services and others have increased sharply in 2012 with the development of some self-service solutions they set up.

All operating expenses are thus firstly related to their stores (representing just above 40% of the total revenues). These stores are mainly financed by their own money (the cash at end of the period is almost equal to the one at the beginning of the period for 2011/2012) even though the company which allows them to be quite independent from the market.

Debt is representing less than 40% of the total Liabilities and Equity, around 2/3 of the debt is short-term debt (accrued liabilities) which allows the firm to have a bit more flexibility in the short-term, more especially on inventories. The 60% left are represented by equity investees and are responsible of around 1.5% of the revenues.

Rates of growth in revenues are extremely promising compared to the average rate of the market (1.07% in 2018, csimarket.com).

	Yearly revenues evolution : (N+1/N)-1		
	2010	2011	2012
Net revenues	0%	7.46%	9.37%
Licensed stores	0%	15.12%	20.13%
CPG, foodservices and others	0%	22.08%	46.60%

Inventories have been increased a lot in 2011 to counter the large investments in new stores.

	Yearly inventory evolution : (N+1/N)-1		
	2010	2011	2012
Inventories	0%	77.77%	28.55%

Margins are evolving positively excepted for 2012 margin which have been lowered down by 2.27%. It can be explained by the increase in income tax induced by the high amount of sales combined to the stagnation of the EBIT.

	Yearly margins evolution : (N+1/N)-1		
	2010	2011	2012
EBITDA margin	22.09%	25.42%	25.42%
EBITDA evolution	0.00%	15.09%	0.02%
Operating margin	13.42%	15.48%	15.48%
EBIT evolution	0.00%	15.34%	0.02%
Margins in %	8.83%	10.65%	10.40%
Margin evolutions	0.00%	20.56%	-2.27%

Over the year 2012, global trends have shifted slightly to create a “scissor effect” : costs have been reduced (87% to 86.6% without taxes) but revenues kept growing up (by 9.37%) what can show an advanced cost control.

To conclude, during this period of three years, Starbucks was earning the large part of its revenues from their own operated stores through a wisely managed cost control. Starbucks was also expending its two other segments, allowing the company to reduce its costs in its balance sheet by using less costly distribution methods. Starbucks seemed to want to focus on these two segments to lower its global costs’ impact.
Taxes were also extremely well optimized as the company has paid around 5% overall of income taxes.

II. Investment Policy

A. Working Capital

Working Capital is the difference between current assets and current liabilities and measures the company’s short-term liquidity.

	2012	2011	2010
Working Capital (WC)	**1,989.8**	**1,719.1**	**977.3**
Sales	13,299.5	11,700.4	10,707.4
WC / Sales	**15%**	**14.7%**	**9.1%**
Net OWC	1,384.1	1,019.5	791.2
OWC turnover	**31.7 days**	**26.5 days**	**22.5 days**

Starbucks has a positive working capital which represents a good indication of financial health. Its working capital increased between 2010 and 2012 from 977.3 to 1,989.8. It raised more than sales as the working capital to sales ratio is growing. The firm can finance its growth, face short-term bills and pay the costs related to new sales itself. Nevertheless, the inferiority of sales increase in comparison with working capital reflects that the firm's management neglected to manage working capital rigorously and focused too much on sales in 2011. Indeed, working capital faced a peak during this year with a hike of more than 75%. This is probably due to the structure change triggered by the introduction of a new direct distribution model for packaged coffee during the second quarter of fiscal 2011.

Net operating WC (OWC) only contains operating current assets (cash, receivables and inventories) and operating current liabilities (payables and accrued liabilities). It doesn't show the same peak as WC in 2011. The increase of Net OWC was just due to the raise of inventories. The peak of WC was caused by the surge of short-term investments for the launch of the new distribution model. Consequently, OWC turnover raised from 22.5 days to 31.7 days between 2010 and 2012 according to the increase of inventories through the years.

	2012	2011	2010
Receivables	485.9	386.5	302.7
Receivables turnover	27.4	30.3	35.4
DSO	11.1 days	10 days	8.6 days
Payables	398.1	540	282.6
DSP	20.8 days	33.4 days	19.5 days
Inventories	1,241.5	965.8	543.3
DIO	34.1 days	30.1 days	18.5 days

The number of days of inventories corresponds with the evolution of inventories and furthermore with the evolution of OWC turnover. The company did not adjust production levels and days of inventories increased from 18.5 days to 34.1 days in 2012. Accounts payable significantly raised in 2011. Because of inventories, suppliers reduced payment delays in 2012, afraid by the risk of impairment. In the meantime, customers faced financial problems and the average payment delay of customers increased. Therefore, Receivables turnover or sales to accounts receivable ratio declined from 35.4 to 27.4 between 2010 and 2012 despite the increasing number of receivables.

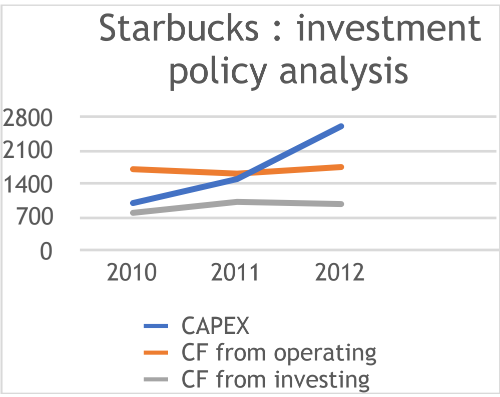
However, days inventory outstanding (DIO) surged by more than 60% in 2011 but only by 13% in 2012. In addition, the payment terms of customers in 2012 reveals the effort of the company to stabilize the situation as for the DSP. The company seems to have prevented a recession started in 2011 by wrong strategies.

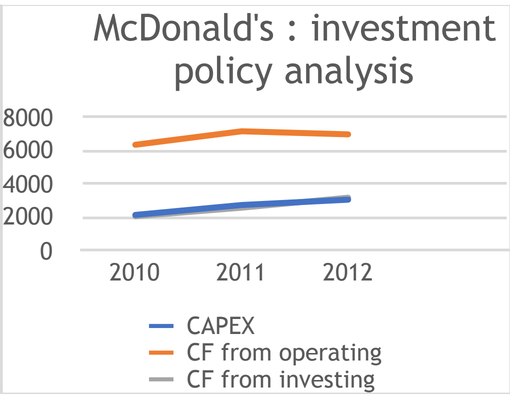
B. CAPEX and investment analysis

CAPEX or Capital expenditures represents the money invested by the firm to purchase new fixed assets or to improve fixed assets already installed (PP&E : property, plant and equipment). CAPEX can be found in the cash flow statement by total purchases of PP&E and additions to PP&E. For example in 2012 : CAPEX = 1749 + 856 = 2605.

	2012	2011	2010
Net fixed assets	2,658.9	2,355	2,416.5
CAPEX	**2,605**	**1,498**	**995**
CF from operating	1,750	1,612	1,705
CF from investing	974	1,020	790

CAPEX of Starbucks has raised through the years and widely exceeded depreciation charges for each year. The company was expanding its industrial structure by increasing its production capacity. In the meantime, cash flows from both operating activities and investing activities were quite stable from 2010 to 2012, even if the peak of working capital of 2011 impacted the operating cash flow.





Since 2010, Starbucks has overly invested in its long-term assets. Consequently, CAPEX passed over operating cash flow in 2011 and company came from profitability to over-investment. However, even if this situation was a little worrying, the maturities and calls of investments have covered the capital expenditures and maintained the cash flow from investing operations. In addition, the peak of CAPEX in 2012 triggered the rebound of operating activities cash flow.

In comparison, the investment policy of McDonald's shows that the company presents a solid investment situation with a slight growth of CAPEX, which is confused with investing cash flow, and a steady operating cash flow. The company globally displays a healthy investment position although its operating cash flow seems to slightly decline.

III. Financing Policy

A. Debt and Equity

To calculate Net Debt, we must sum up short-term debt (current liabilities) and long-term debt, then subtract cash and cash equivalent.

	2012	2011	2010
Free Cash Flow	776	592	915
Net Debt / EBITDA	0.46	0.50	0.49
Long term debt / total Assets	0.07	0.07	0.09
Equity multiplier	1.61	1.68	1.74

Starbucks has generated large cash flows from operating activities that have been easily able to cover investing needs. The drop of Free Cash Flow in 2011 was a consequence of working capital increase and wrong decisions of the company this year. Nevertheless, the Free Cash Flow increased in 2012 and the company seems to have reinitiated its growth. Starbucks has financed its costs with an operating cash flow which also allowed the company to distribute dividends. Indeed, between 2010 and 2012, distribution of dividends increased from 171 to 513. The rest of the company's income was reinvested in the firm as retained earnings (equity).

The equity multiplier of the firm measures its dependence on debt. Starbucks's equity multiplier has decreased across the years. It shows that the company was financed by stockholders and by its activities which is a positive indicator. In the meantime, net debt to EBITDA ratio reflects the absolute ability of the company to repay its debt while long-term debt ratio confirms the financing policy of Starbucks.

Consequently, Starbucks had a very positive financial position with a strong operating cash flow and an effective financing policy which allowed the firm to be self-financing and to pay dividends.

B. Liquidity

Starbucks	2012	2011	2010
Current ratio	1.90	1.83	1.55
Quick ratio	1.34	1.36	1.24
Cash ratio	0.54	0.55	0.65
McDonald's	2012	2011	
Current ratio	1.45	1.25	
Quick ratio	1.41	1.22	
Cash ratio	0.69	0.67	

The current ratio measures a company's ability to face its current liabilities with all its assets. The current ratio of Starbucks grew through those years so the company had a good liquidity position. These ratios are bigger than McDonald's current ratios which is an additional indication of the reliable of Starbucks liquidity.

The quick ratio and the cash ratio measure a company's ability to pay off its current liabilities with certain items of its current assets. These ratios were stable for Starbucks and shows that the current ratio increase was due to the rise of inventories. On the other side, the quick ratio and the cash ratio of McDonald's raised as its current ratio.

The liquidity position of McDonald's looks healthier than Starbucks. This financial situation does not appear alarming, but the company needs to stabilize its inventories so that it can present a homogeneous liquidity growth. Starbucks has kept a strong financial position even if we can see here the impact of investment policy.

IV. Profitability

A. ROCE

The ROCE (Return On Capital Employed) ratio is an indicator of profitability for the company. In fact, it measures the level of efficiency regarding the use of the company's capital. This defines the extent to which a company uses its capital to generate profit. It is widely used by investors wishing to know whether it is interesting to invest in a company or not.

	2010 ($M)	2011 ($M)	2012 ($M)
EBIT	$1 437,0	$1 811,1	$2 059,1
Total Assets	$6 385,9	$7 360,4	$8 219,2
Current Liabilities	$1 779,1	$2 075,8	$2 209,8
ROCE (EBIT / Total Assets + Current Liabilities)	17,60%	19,19%	19,74%

$$= \frac{\text{EBIT}}{\underbrace{\text{Total Assets} - \text{Current Liabilitie}}_{\text{Capital Employed}}}$$

Starbucks had a ROCE ratio of 19.74% in 2012, this ratio has increased about 2.14% in two years. Compare to other companies in the same field of activity, it is correct but less than McDonald's for example, which had 24% of ROCE in 2012. This ratio showed that Starbucks had increased its capacity to create value with its capital, although it is still weaker than its main competitor; but also that investing in this value in 2012 was more interesting than 2010 because it created more value with its capital.

B. ROE

The ROE (Return On Equity) ratio is an indicator that measures the ability of a firm to generate profits from its shareholders investments in the company, the return on equity ratio shows how much profit each dollar of common stockholders' equity generates.This is an important measurement for potential investors because they want to see how efficiently a company will use their money to generate net income.

	2010 ($M)	2011 ($M)	2012 ($M)
Net Income Annual	$945,6	$1 245,7	$1 383,8
Shareholder's Equity	$3 674,7	$4 383,9	$5 109,0
ROE (Net Income Annual / Shareholders' Equity)	25,73%	28,42%	27,09%

$$\text{ROE} = \frac{\text{Net Income (annual)}}{\text{Shareholders' Equity}}$$

Starbucks had a ROE ratio of 27.09% in 2012, increasing about 1.36% in three years. Compared to other companies in the same field of activity, this is not a bad result, but less than McDonald's for example, which had 38.45% of ROE in 2012. However, the real problem of Starbucks was its increase of equity, shifting faster than the increase of its Annual Net Income, which had for consequence a decrease in rentability of equity invested.

The real impact on its activity was accordingly that investors could potentially reduce their investment because of the decrease of ROE, so they could lose capital which helps them to invest for the company's expansion.

However, it should still be pointed that it remained on the rise during this three years period, which is a positive point for investors.

C. Leverage effect

A leverage ratio is a financial ratio that indicates the level of debt incurred by a business entity against several other accounts in its balance sheet, income statement, or cash flow statement. These ratios provide an indication of how the company's assets and business operations are financed with debt or equity.

Leverage Ratios of Starbucks

Financial Info	M$		
	2010	2011	2012
Assets	$2 756,4	$3 794,9	$4 199,6
Debt	$2 703,6	$2 973,1	$3 104,7
Equity	$3 682,3	$4 387,3	$5 114,5
EBITDA	$1 944,7	$2 332,1	$2 608,5

Leverage Ratios			
	2010	2011	2012
Debt/Assets	0,98	0,78	0,74
Debt/Equity	0,73	0,68	0,61
Debt/Capital	0,42	0,40	0,38
Debt/EBITDA	1,39	1,27	1,19
Assets/Equity	0,75	0,86	0,82

All this different leverage ratios showed that the activity of Starbucks were more financed by debt than equity, 73% of it being indeed owned by banks with loans in 2010. This percentage was reduced in 2012 to 61% (minus 12% in two years).

This can be interpreted as a fact that the company wanted to be more independent with banks to increase the weight of equity in their assets, which was a really good choice because it is less risky to increase equity than debt. We can also notice that the percentage of debt in assets and capital has declined (Debt/Assets : 98% in 2010 to 74% in 2012, minus 24% | Debt/Capital : 42% in 2010 to 38% in 2012, minus 4%) which is consistent with the debt's decrease to favor equity.

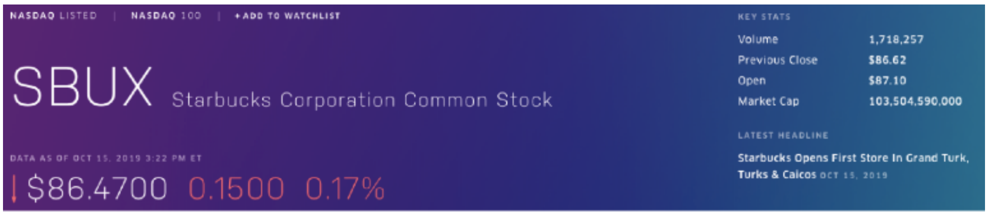
In fact, debt financing also requires debt servicing or regular interest payments. Companies leveraging large amounts of debt might not be able to make the payments. That's why debt can be a far more expensive form of financing than equity financing.

Moreover, we can see that the percentage of debt financing the EBITDA has decreased in the three past years. That's a good point for Starbucks because the firm decreased this percentage for about 20% in these past years. It suggests that creation of cash issued to operational activities were more independent of debt than three years ago.

Compared to other companies in the same field of activity like McDonald's, Starbucks had 131% in 2010 owned by banks and 136% in 2012 (increase of 5%). This indicates that Starbucks had a more independent system about creation value in operational activities than McDonald's.

All this information permitted to state that Starbucks has had a profitable management of its activity. Every indicator is flashing green to improve the success of the firm. Indeed, it has reduced its debts, increased its equity to be more flexible and less dependent of banks and improved the return on shareholders’ equity.

V. Share Performance Analysis



Price per share during the period (2010 – 2012) :

Price per share in the 01/04/2010 : $11.5250

Price per share in the 12/31/2012 : $26.8150

Increase of $15.29, either an evolution of 133.7% in three years.

The profitability analysis of the firm is coherent with the performance of the share value for these three years. Investors had more interest to pick this stock because of the reduction of the bank’s importance.

Conclusion

For the 2010-2012 period, Starbucks has been a fairly stable and expansive company, rather cash-focused because it has had relatively weak debt and has been mostly financed by itself and with equity. It has reduced its moves in developing on its other markets. These markets have not required direct investments on the stores which has allowed Starbucks to have a rather convincing margin. It also has lowered its taxes thanks to a good fiscal management and an accurate control of costs.

The company owns a great wellness through its activities, but should be more cohesive relating to its policies, stabilize its inventories, in order to stimulate its cash growth and make it more efficient.

Starbucks has taken position as a good opportunity for investors, by improving its return on shareholders' equity and its capacity to create value with its capital. It still has to pay attention on its investments, especially on long-term assets which it seems to avoid since then.

Globally, relying on these previous points mentioned, the company might create an enhancing independence and an essential visibility to keep flourishing worldwide as the number one coffee producer.

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