UPDATING THE SBUX MODEL
FISCAL 4TH QUARTER 2022 RESULTS

Starbucks Earnings Release (November 3, 2022)

For the most part, there was limited new information provided on the fiscal fourth quarter 2022 earnings conference call which was not previously discussed at the Investor Day meeting held in September. Management reaffirmed the long-term guidance, but did provide the following specifics for 2023:

- Global Comparable Store Sales Growth Near the high end of 7% - 9%
    - U.S. Comparable Store Sales Growth 7% - 9%
    - China Comparable Store Sales Growth Outsized
- Global Store Growth ~7%
- U.S. Store Growth ~3%
- China Store Growth ~13%
- Global Revenue 10% - 12%
- Global Operating Margin Solid margin expansion
- Capital Expenditures ~$2.5B
- Interest Expense $540M - $560M
- GAAP and non-GAAP Tax Rates Mid-20s
- GAAP and non-GAAP EPS GAAP: High end of 15% -20% range

As a reminder, the key guidance points from the Investor Day conference included the following:

- Global store growth of 7% annually approaching 45,000 stores by the end of 2025 (from fiscal 2023 to 2025). Growth in fiscal year 2024 and 2025 is expected to be higher than 2023.
    - U.S. store growth 3% to 4% annually (from fiscal 2023 to 2025).
    - China store growth of 13% annually.
- Global revenue growth of 10% to 12% annually (from fiscal 2023 to 2025).
- “Solid” margin expansion in fiscal 2023 with “progressively more expansion” in fiscal 2024 and 2025.
- Non-GAAP EPS growth of 15% to 20% annually through fiscal 2025.
- Share buyback program is expected to be reinstated in fiscal 2024 and provide 1% impact to EPS (net of incremental interest).
- Dividends and buybacks expected to return $20B to shareholders from fiscal 2023 through 2025.
- Dividend payout ratio of approximately 50% (which equates to an estimated yield of about 2%).
- Capital expenditures of $2.5B to $3.0B annually (fiscal 2023, 2024, and 2025).
- Debt levels likely to increase but maintain long-term leverage target of three times lease adjusted EBITDA.

Considering the results from the fourth quarter and the updated guidance, the Base Case forecast thesis has been adjusted slightly as reflected in the “blacklined” update to the written thesis below:

> *The Base Case version of the model assumes that strength in the North America business will continue ~~into~~ through fiscal 2023, moderate to some extent on a percentage growth basis in 2024 on a comparable basis after a strong 2023, followed by low-double digit growth for fiscal 2025 in line with management’s long-term growth guidance. This will be the result of the aggressive store growth plan provided by management, as well as the impact of secular growth trends including the benefit from technology, continued demand for higher-priced cold beverages (although from a product share standpoint hot beverages may begin to regain a few percentage points), customization, food attach, and rewards program success. If there is a further economic*

slowdown or recession in the U.S. the Base Case will assume that Starbucks will continue its position of strength, including pricing power and minimal experience with customer trade-downs or trade-offs.

Based on management's guidance operating margin is expected to see "solid expansion." ~~be lower in the fiscal fourth quarter of 2022 compared to the third quarter, followed by "Solid" margin expansion~~ in fiscal 2023 with "progressively more expansion" in fiscal 2024 and 2025. ~~These expected trends will be reflected in the Base Case version of the model. The lower margin in fiscal fourth quarter will likely be driven by the strategic investment in partners (wage inflation) and inflation driven by supply chain pressure.~~ From an operating expense standpoint, the Base Case assumes North America Segment wages will continue to increase (which shows up primarily in the store operating expense and general and administrative expense lines). The Base Case assumes that inflation will begin to moderate through fiscal 2023. Product input and distribution cost inflation shows up in the product and distribution cost expense lines. The Base Case will assume these headwinds moderate beginning in 2023. In addition, sales leverage will result in margin improvement through 2025.

For the International Segment the Base Case assumes the strength in the dollar will subside to some extent in 2023 and the impact of COVID lockdowns and restrictions will moderate in fiscal year 2023 and into 2024. The International Segment is coming off a weak period in terms of revenue growth, so the Base Case will assume the favorable comparison against this weak period will be the primary source of the double-digit growth in management's high-level revenue guidance. The revenue growth will also present a sales leverage tailwind to operating margin. This when paired with reduced pressure from inflation and currency translation will result in a progressively expanding margin through the forecast period.

To reflect the results from the fourth quarter and the few additional details provided for fiscal 2023, the following updates have been made to the Starbucks model:

- **Net New Stores:** The assumptions for new stores have been left unchanged from the estimates prior to the fourth quarter release. U.S. store growth (a proxy for the North America Segment) is expected to be approximately 3%. As it stands the model is forecasting 3% growth in North America stores. China is not as close of a proxy for the International Segment as the U.S. is for North America. For example, in the last quarter (fiscal 4Q2022) China's store count grew 12% while the International Segment grew by just 8%, a difference of 4 percentage points. Currently management has guided China store growth in fiscal 2023 to approximately 13%. The model is currently forecasting 10.7% growth in stores for the full International Segment, which seems reasonable at about 2.3% below the China-only forecast. Currently the Base Case is modeling 43,694 stores by 2025 which remains generally in-line with management's long-term guidance of "approaching 45,000" by 2025. Long story short, no changes have been made to the store count forecast.
- **Revenue (Fiscal 2023):** The forecast looks reasonable when compared to management's guided range as 11.6% falls slightly above the mid-point of management's range of between 10% and 12%. The forecast also looks reasonable compared to the average revenue per store achieved in the fiscal fourth quarter.
- **Operating margin (Fiscal 2023):** To reflect an expectation of declining input prices, the product and distribution costs have been adjusted down slightly (25 basis points) in the last three quarters of 2023 for the North America Segment. The Base Case assumes approximately 110 basis points of margin expansion (on a GAAP basis) coming from the International Segment.
- **Capital Expenditures:** Management has updated their guidance to the low end of their previous range at approximately $2.5B. The modelled capex has been adjusted slightly to reflect this.
- **Interest Expense:** Management provided guidance for fiscal 2023 interest expense to between $540M and $560M. The interest expense forecast has been adjusted to meet the midpoint of this guidance at $550M.
- **Tax Rate:** Management provided new guidance for the tax rate at "mid-20s" which was in-line with the previous Base Case forecast of 24.5% so no adjustment has been made to this line.

- **GAAP EPS (Fiscal 2023):** Based on the assumptions above, the resulting GAAP EPS of $3.37 represents growth of 19% year-over-year. This is in-line with management's guidance of GAAP EPS at the high-end of the 15% to 20% range.
- **Non-GAAP EPS (Fiscal 2023):** Management guided non-GAAP EPS to the low-end of the 15% to 20% range. This implies non-GAAP adjustments of approximately $90M, to reach a non-GAAP EPS growth rate of approximately 16%. The $90M total fiscal 2023 non-GAAP adjustments have been added to the model, spread between the four quarters.

The next step is to check the impact on the forecast through 2023 to make sure it is reasonable when compared to the long-term guidance management provided at the Investor Day meeting in September, since they reaffirmed this guidance on the fiscal fourth quarter conference call.

- **Revenue:** The Base Case is currently modeling a CAGR in revenue from 2022 through 2025 of 11.2% which is in-line with management's guidance of between 10% and 12%.
- **Operating Margin:** Management projects "Solid" margin expansion in fiscal 2023 with "progressively more expansion" in fiscal 2024 and 2025. The Base Case includes non-GAAP margin expansion of 110 basis points, 70 basis points, and 90 basis points for fiscal years 2023, 2024, and 2025 respectively.
- **Non-GAAP EPS:** Management expects EPS growth between 15% to 20%. The Base Case is currently modeling a CAGR of 17.9%.
- **Dividends and Share Repurchases:** The model's dividend payout reaches management's long-term goal of 50% by 2025, therefore, no changes to the dividend assumptions are required. The share repurchase assumptions have been increased in the last two quarters of 2025 from $5.2B to $5.4B. This brings the model's forecasted EPS impact of share repurchases to approximate 1% (in-line with guidance). The resulting adjusted debt-to-EBITDA ratio of 3.2x (including the impact of debt issued to fund repurchases) is reasonably close to management's long-term target of 3.0x. Including these assumptions, the model is forecasting a total share repurchase and dividend return to shareholders of approximately $19B, which is reasonably to close to management's guidance of approximately $20B.