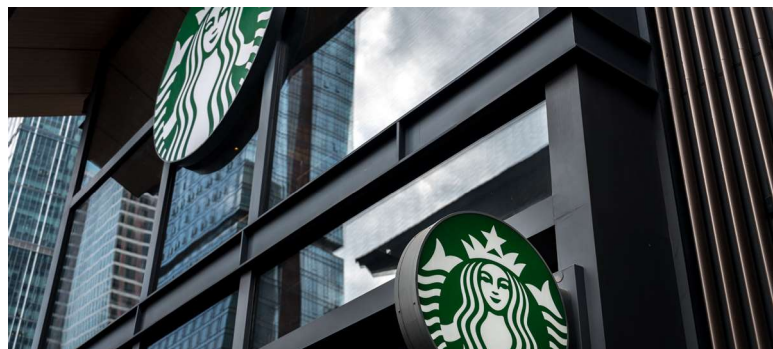


Starbucks

The Green Siren with a vast ocean in front of it



Starbucks operates a network of 32000 company-owned (51% of total stores) and licensed (49%) coffee shops across 81 countries. The company sells premium coffees, espresso, teas, cold beverages, and foods. The company also distributes retail coffee products through partnerships with Nestle (such as the Starbucks branded coffee capsules that are compatible with Nestle's Nespresso machines) and PepsiCo.

WHAT WE LIKE

The company is well positioned to benefit from the attractive growth opportunity in the specialty coffee market. Despite the lack of barriers to entry in the industry, Starbucks has a strong brand that resonates with customers providing the company with pricing power to inflate price every year with very little change in volume. Starbucks is the global leader with almost 50% market share globally and an even stronger position in its core markets, US and China. The company can use its strong market share to build an even more loyal customer base that will be prone to consume even more of its products (members of the Starbucks loyalty program, which stood at 19.4 million active members in the US up 15% YoY in Q2FY2020, buy more frequently and spend more money on each visit than non-members), to innovate new products and to keep developing digital solutions.

The growing Chinese market is currently management's focus, and they see this region being as big as the US market in the future. The growth in the Chinese business is being driven by an increasing middle-class population, a strong Chinese desire for international brands and a very low per capita coffee consumption (0.1 kg per capita versus 4.1kg per capita in the US) that is bound to grow in the future as they become increasingly "westernized".

Starbucks started paying a dividend in 2010 and since then, has grown total dividends by an impressive 9-year CAGR of 37%. On a per share basis, average dividend growth has been 27% over the same period. The company's management team is increasingly returning more capital to shareholders through share buybacks and dividend payments, which we expect to continue to grow in the future.

IMPACT OF THE CORONA VIRUS PANDEMIC

Starbucks' share price was not immune to the broad market sell-off driven by fears surrounding the COVID-19 and the subsequent global economic recession. Indeed, the share price went from more than \$90 to \$50 before rebounding sharply to north of \$80, currently trading at \$70 per share. It is obvious that short-term earnings will be depressed, using past financial crises as an indicator of what to expect. A large majority of the company's stores were closed due to global lockdown regulations. These temporary closures were partially offset by drive-thru stores and online delivery. In the coming months, sales, which are discretionary in nature, could be hurt by high unemployment, social distancing measures and a global shift towards working from home. However, the company has enough financial flexibility to navigate these challenging times with a loyal customer base, and as such we believe that the favorable long-term prospects of the company are still present.

WHERE DO WE STAND (OR SIT)?

Starbucks is a good quality company with a long-term track record of above-average returns relative to the market. The company has one of the most iconic brands in the world, providing the company with strong pricing power and low earnings variability. Furthermore, the management team is shareholder-friendly, and we expect dividends to continue to grow at double-digit rates (albeit lower than the 27% average growth recorded since the company started paying a dividend) into the future. Starbucks' strong business model and low earnings variability should offer above average long-term returns to shareholders as the company continues to compound its earnings over time. •

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