

Starbucks Shares Looking Attractive

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Founded in Seattle in 1971, coffee retailer Starbucks Corp. (NASDAQ:SBUX) has been an incredible business success story. At the time of the company's initial public offering in 1992, it had 140 stores.¹ Today it has more than 27,000 stores across 75 countries.² Our goal when examining companies like Starbucks is always to find investments that fit our investment philosophy and could be potential holdings in our discretionary model portfolios. Our investment philosophy is that buying high-quality businesses trading at undervalued prices leads to good returns over time.

Is Starbucks a High-Quality Business?

High-quality businesses often have significant competitive advantages that differentiate them from competitors. They typically have long track records of success and above-average profitability. Starbucks looks like a high-quality business to us.

Its business is simple and understandable, and its brand is meaningful to customers. Starbucks was recently ranked as the 60th most valuable brand in the world by a brand consultant.³ Its financial track record is excellent. Over the past 10 years, sales and earnings per share have grown at annual rates of around 13% and 19% respectively.⁴ The company is very profitable. For example, in recent years, net profit margins have hovered around 13%.⁵

Are Starbucks Shares Undervalued?

Two years ago, Starbucks shares were trading around US\$61. Today they are trading around US\$54. There have been no significant missteps by the company to cause this share price stagnation, although its growth in the U.S. is slowing, perhaps due to the high number of stores. Investors were simply paying too high of a valuation for the stock in 2016.

Starbucks earnings per share have risen from US\$1.91 in 2016 to US\$2.06 in 2017 and are estimated by analysts to rise to US\$2.51 in 2018.⁶ Sales have risen from US\$21.3 billion in 2016 to US\$22.4 billion in 2017 and are estimated to rise to US\$24.7 billion in 2018.⁷ Management recently provided some long-term financial targets. These included annual revenue growth in the high single digits and annual earnings per share growth of 12% or greater.⁸

At US\$54, shares are trading around 22 times 2018 earnings per share estimates, a valuation we view as fair. On February 6, we purchased a 1% position in Starbucks in our Total Return Portfolio at a price of US\$54.65. 1% is a small position, and we may look to increase our holdings in the coming months, especially if the valuation gets lower. We believe that the company has a good chance of meeting its financial targets. Three

probable sources of growth are the company's expansion in China, its efforts to sell more food, and its increasing customer engagement through its mobile app and its Starbucks Rewards program. In addition to the growth potential, Starbucks now offers a dividend of US\$1.20 annually, which gives shareholders a yield of around 2.2%.

Conclusion

We now have a small position in Starbucks for clients invested in our Total Return Portfolio. Starbucks is a potential holding for our Balanced Portfolio as well, depending on price action and the flow of new information. Starbucks' dividend yield is not currently high enough to fit the objectives of our High Yield Portfolio.

Thank you for reading this article. It is important to us that clients understand our investment philosophy of purchasing high-quality companies at undervalued prices. We believe that this is the best way to invest for the long-term. As always, we welcome any questions you may have about this article or other topics of interest. Thank you for your business.

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¹ <https://en.wikipedia.org/wiki/Starbucks>

² <https://investor.starbucks.com/press-releases/financial-releases/press-release-details/2017/Starbucks-Reports-Q4-and-Full-Year-Fiscal-2017-Results/default.aspx>

³ <http://interbrand.com/best-brands/best-global-brands/2017/ranking/starbucks/>

⁴ Value Line report on Starbucks Corp. dated August 25, 2017

⁵ Value Line report on Starbucks Corp. dated August 25, 2017

⁶ Data sourced from Bloomberg on February 7, 2018

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⁸ <https://investor.starbucks.com/press-releases/financial-releases/press-release-details/2017/Starbucks-Reports-Q4-and-Full-Year-Fiscal-2017-Results/default.aspx>

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