

# Starbucks financial statement analysis



The intent of this paper is to research and analyze the financial statement of Starbucks, a locally originated (yet global) publicly traded, Pacific Northwest Company. Resources used are the 2010 10-K, the DataMonitor company profile, Mint Global, and the NetAdvantage Corporate Social Responsibility reports, as well as several cited online resources. Company Overview Starbucks Corporation originated as a single store in the Pacific Northwest – downtown Seattle, WA in Pike’s Place Market over 40 years ago.

The company started in 1971; the corporation was formed 1985. The Starbucks Mission Statement follows: “ Our mission: to inspire and nurture the human spirit – one person, one cup and one neighborhood at a time. ” Starbucks purchases and roasts high quality whole coffee beans, creates handcrafted coffee and tea beverages, offers pastries and treat food items, and serves them passionately via a rewarding customer ‘ experience’ of coffee, tradition, and a feeling of connection.

Also available for purchase in-store are merchandise products centered on espresso and coffee, packaged goods, music, books, and gift items. In 1983 Howard Schultz (Starbucks chairman, president, and CEO) pursued his vision to bring the Italian coffeehouse tradition to the United States; a place for the neighborhood to gather for conversation and a sense of community. Today Starbucks stores have grown to 15, 000 in 50 countries, and Starbucks is the premier roaster and retailer of specialty coffee in the world.

Starbucks is attempting to stand as the most recognized and respected brands in the world. The company operates via a few channels: company-operated retail stores, licensed retail stores (specialty operations), and

licensing of its trademark. There are three reportable operating segments: United States (US) International Global Consumer Products Group (CPG) The US and International segments both include company-operated retail stores and certain components of specialty operations. Specialty operations within the US include licensed retail stores.

International specialty operations include retail store licensing operations in nearly 40 countries and foodservice accounts in Canada and the United Kingdom (Starbucks Corporation, 2010). The CPG segment includes packaged coffee and tea, Starbucks VIA® Ready Brew and other branded products sold worldwide through channels such as grocery stores, warehouse clubs and convenience stores, and US foodservice accounts. CPG operates a significant portion of its business through licensing arrangements and a joint venture with a large consumer products business partner (Starbucks Corporation, 2010).

Competition With respect to coffee beverage sales, Starbucks competes with quick-service restaurants (QSR's) and specialty coffee shops such as Tully's and Caribou Coffee. They also experience direct competition from large competitors such as McDonalds and Dunkin' Donuts. The packaged coffees and teas compete directly against other specialty coffees and teas (such as Peet's, Dunkin' Donuts, Millstone) sold through supermarkets, club stores, and specialty retailers (Starbucks Corporation, 2010).

The company also has to compete against restaurants and other specialty retailers for prime retail locations and qualified personnel to operate the stores. Following is some chart comparison information: [pic] [pic] [pic]

Corporate Social Responsibility Report Starbucks has been one of the leaders in being a socially responsible company. It is involved in local charities focusing on children, the environment, arts, and AIDS research, and providing coffee donations to homeless shelters in the state where their stores are located.

It has formed alliances to distribute books through annual drives and it has given away over 320, 000 new books. Other alliances include CARE, the international relief and development, and GLEP in Guatemala to limit child labor and guaranteeing workers rights to free association. Auditors Report The Auditor's report is designed for the Board of Directors and current Shareholders and Potential investors Starbucks Corporation. It audits the internal control over financial reporting of Starbucks and its subsidiaries in accordance with the Standards of the Public Company Accounting Oversight Board of the United States.

The report looks for any misstatements or occurrences of fraud within the company. Auditors are required to plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. In addition, they assess the risk if a material weakness exists, test and evaluate the design and operate effectiveness of internal control based on the assessed risk.

It is important for auditors to determine that a company's internal control over financial reporting includes those policies and procedure that:

- Pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the business •

Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company • Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Starbucks financial statements were audited by Deloitte & Touche LLP based in Seattle, WA Stock Common Stock

The aggregate market value of the voting stock held by non-affiliates of the registrant as of the last business day of the registrant's most recently completed second fiscal quarter, based upon the closing sale price of the registrant's common stock on March 26, 2010 as reported on the NASDAQ Global Select Market was \$16 billion. As of November 12, 2010, there were 741. 1 million shares of the registrant's Common Stock outstanding.

Preferred Stock Starbucks have authorized 7. 5 million shares of preferred stock, none of which was outstanding at October 3, 2010. Total Paid In Capital  $106. 2 + 39. 4 = 145. 6$  million Under applicable Washington State law, shares repurchased are retired and not displayed separately as treasury stock on the financial statements.

Instead, the par value of repurchased shares is deducted from common stock and the excess repurchase price over par value is deducted from additional paid-in capital and from retained earnings, once additional paid-in capital is depleted. Dividends Cash dividends declared per share is \$0. 36, Starbucks paid dividends for the last three quarters at \$. 10, . 13, and . 13 respectively.

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Performance Comparison Graph: The graph below shows the total return to shareholders from October 2, 2005 through October 3, 2010 relative to the performance of the S&P 500, the NASDAQ Composite Index, and the S&P 500 Consumer Discretionary Sector (a group which includes Starbucks) (Starbucks Corporation, 2010). [pic] Ratio Evaluations

Liquidity – Working Capital to Sales, liquidity ratios show the ability to meet short-term obligations as they come due. Current Ratio is Current Assets /Current Liabilities  $2756.4/1779.1 = 1.55$  Because this number is over 1.0, this shows that Starbucks is in relatively good short term financial standing. Quick Ratio is Cash + ST Investments + Receivables (net)/Current Liabilities  $1164+236.5+49.2+302.7/1779.1 = 1.7524/1779.1 = .98$  A quick ratio of 1.0 or more is accepted by most creditors; however quick ratios vary greatly from industry to industry. Current Cash Debt Coverage Ratio is Net Cash Provided by Operating Activities/Average Current Liabilities  $1704.9/((1779.1+1581)/2) = 1704.9/(1680.5) = 1.015$  Inventory Turnover is Cost of Goods Sold/Average Inventory =  $8010/(543.3+664.9)/2 = 3.32$  This number indicates that there would be 4 inventory turnovers per year, meaning that it would take 3 months to sell the entire inventory on hand. Solvency – Relate to asset management, debt management and interest coverage. This number measures the percentage of a company's assets that are financed by debt in order to determine the company's overall financial risk. Debt to Total Assets Ratio is Total Debt/Total Assets  $2703.6/6385.9 = .42$  Times Interest Earned is Income before Income Taxes and Interest Expense/Interest Expense  $1469./32.7 = 44.94$  Cash Debt Coverage Ratio is Net Cash Provided by Operating Activities/Average Total Liabilities = 1704.

$9 / ((2703.6 + 2519.9) / 2) = 1704.9 / 2611.75 = .65$  This number accounts for the changing liabilities and cash flows that a company experiences during the course of a time period. Profitability – These ratios assess the ability to generate earnings as compared to costs and expenses over a period of time. Profit Margin is Net Income/Net Sales  $945.6 / 10707.4 = .088$  Cash Return on Sales is Net Cash Provided by Operating Activities/Net Sales  $1704.9 / 10707.4 = .159$  Asset Turnover is Net Sales/Average Assets  $10707.4 / 6385.9 = 1.68$

This is a measure of how well assets are being used to product revenue.

Return on Assets is Net Income/Average Assets  $945.6 / 6385.9 = .15$  When a high cash return on assets ratio is listed, it can indicate to investors that a higher return is anticipated. This is due to the theory that the higher the ratio, the more cash the company has made available for reinvestment or replacements in the company. Return on Common Stockholders Equity is Net Income/Average Common Stockholder Equity  $945.6 / ((2284.1 + 2490.9 + 3045.7 + 3674.7) / 4) = 945.6 / 2873.85 = .329$  Earnings Per Share is Net Income/Weighted Common Average Shares Outstanding  $945.6 / ((744.4 + 764.2) / 2) = 1508.6$  so  $945.6 / 754.3$  is  $1.25$

Price/Earnings Ratio is Market Price per Share of Stock/Earnings Per Share  $25.89 / 1.25 = 20.71$  Payout Ratio is Cash Dividends per Share/EPS  $171 / 945.6 = .18$  Cash Position Cash provided by operating activities was .3 billion higher in 2010 than 2009 (1.7 compared to 1.4). The 10-K states that this increase was due to higher net earnings for the period. With regards to investing activities, Starbucks used a portion of its available cash to purchase US Agency investment grade bonds. Capital expenditures went <https://assignbuster.com/starbucks-financial-statement-analysis/>

toward remodeling and renovating existing company operated retail stores, opening of new retail stores, and investments in updated information technology systems.

Cash spent for financing activities totaled 346 million, reflecting repayments of commercial paper and short term borrowings under the credit facility. This was offset by dividend payments of 171 million, and common stock buy-back of 286 million. Comparison Below is some information showing how the company's performed compared to similar companies and/or industry standards. Starbucks also provides a higher than industry wage and benefits (as compared to its competitors). [pic] Operating Policies In January 2008, company founder Howard Schultz returned to his role as President & CEO to help Starbucks address the deterioration of US retail sales and address its global support structure.

Good entrepreneurs are not necessarily good managers – it takes creativity and drive to start a company but discipline and delegation to successfully run one. In 2000, Howard Schultz had tired of his role as CEO so had stepped aside from the daily operations to serve only as Chairman of the Board and to focus on expanding Starbucks internationally. In late 2007, when Schultz heard the concerns of Starbucks' partners, it prompted him to write the infamous memo stating that the decline in Starbucks was more the result of an internal lack of focus than the economic downturn. Schultz returned with a sense of urgency for rekindling the company's original passion and belief in the company's future. (Schultz, p. 7) With Schultz, Starbucks management developed a Transformation Agenda, a strategy for Starbucks to return to its roots, to focus on their coffee, their stores, their customers and on creating,

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maintaining and marketing the Starbucks Experience to combat the effects of the recession. This Transformation Agenda involved five strategic shifts: 1) A re-architected cost structure to allow for long-term operating margin expansion 2) A healthier store portfolio achieved through closure of underperforming stores 3) A stronger value and rewards platform consistent with Starbucks premium brand 4) A renewed emphasis and investment around coffee leadership 5) A galvanized company with a common purpose (Starbucks Newsroom, 2008) Although not called a Balanced Scorecard, the Transformation Agenda set out to implement new strategies.

Schultz's first step was to translate this strategy into operational terms. Starbucks had grown rapidly and had lost touch with the principles on which it was founded. The executive team analyzed the company's strengths and weaknesses, focusing on the original strength of providing quality coffee in a friendly neighborhood cafe. Their weakness was that they had grown rapidly and were over extended and their retail outlets had lost the unique style that had originally differentiated Starbucks from the competitors. In 2008, there were two major threats - many imitators (including McDonalds) offering freshly brewed coffee for less and the threat posed by the serious economic condition of their market.

Though it had not seemed to be a weakness a year earlier, many of Starbucks' expenses were fixed costs related to company owned coffee growers, processing plants and retail stores. Starbucks had to make a realistic assessment of these factors and go after any opportunities. This was the focus of the Transformation Agenda. Starbucks evaluated their products and customers and selected operational excellence as their top priority. They

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returned to their original focus of quality, ease of purchase and recreating the Starbucks Experience. On March 4, 2008, Schultz somberly addressed the top management of Starbucks worldwide saying, “ When did we forget that our business is about the customer and our love and passion for the coffee?

As we got tangled in bureaucracy and quarterly comp growth? And why did we stop holding our business operations to the same standards that we hold our coffee? ” (Schultz, p. 104) The first step was to re-architect the company profitability by streamlining, retraining and diversifying. “ Starbucks needed a more disciplined operating system to maximize earning potential. ”

(Schultz, p. 155) Corporate staff was reduced by 1, 000 positions and a \$400 million reduction was made in permanent costs. Schultz focused on ways “ to eliminate spending in ways that were not consumer facing and wouldn’t subtly fracture the culture and values of the company. ” (Schultz, p. 84) To create a healthier store portfolio, Starbucks examined the profitability of its existing stores and refocused their expansion plans. It was agreed that over the years focus had shifted from neighborhood coffee shop to nationwide megastore. Schultz stated in his book that as he looked at the list of the stores to be closed, he first felt a sense of failure and then he realized that “ success is not sustainable if it’s defined by how big you become. ” (Schultz, p. 166) Expansion had been too fast and the Starbucks brand had suffered. The first step was slowing the pace of new store openings and closing underperforming locations – 600 stores in the United States and 75% of the company’s Australian stores.

Starbucks prides itself as a “ good citizen” through their mission statement “

To establish Starbucks as the premier purveyor of the finest coffee in the world while maintaining our uncompromising principles while we grow”

(Starbucks, 2002, p. 3) Product supply: Starbucks entered in a fixed price purchase commitments to secure an adequate supply of high quality green coffee and fix a cost for future periods, to less the risk of the climbing prices of coffee. Employees: Also called ‘ partners’ these employees include part time workers. They are eligible for health care benefits, can participate in the Bean Stock program, 25% matched 401k, and are entitled to a free pound of coffee each week.

Compared to the industry employee turnover of 400%. Starbucks’ is only 50%. Environmental Policies: Mission statement – “ Starbucks is committed to a role of environmental leadership in all facets of our business”

(Starbucks, 2002, p10). Starbucks is achieving this by being cautious of the environmental issues, and sharing information with employees, innovations of flexible solutions to bring change, buying & selling of environmentally friendly products, and recognition of financial responsibility essential to the environmental future. SWOT Analysis and Recommendations Starbucks has worked hard and invested wisely to attain a wide geographical reach.

This is conducive to increase the company’s bargaining leverage, and increases brand equity. Expansion in existing markets a well as new and emerging countries will help to establish a global retail footprint and reduce its dependency on a ‘ few’ markets. Rising coffee prices are a consideration however, which would affect the company’s profitability. An idea to streamline operations might be a Starbucks card with preferred drink and

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payment information embedded in the card. Upon entry into the retail unit, the customer would swipe the card and the IT system would read the drink, send it for preparation, and deduct funds from the client account. The drink would end up waiting for the customer in a more streamlined process.

Another idea would be to expand on the prior idea of using a mobile device ‘ application’ to order and purchase a drink prior to pick up.

Strengths • Wide geographic presence strengthened by continued expansion • Company is currently profitable • Strong ethical values and mission statement • Strengthening presence in alternate distribution channels • Research and development capabilities leveraged to strengthen product portfolio

Weaknesses • Product recalls negatively affect brand image (glass water bottles, grinders, for example) • Almost all cafes are located in the US • Highly dependent on their main advantage – coffee

Opportunities • Growing presence in key Asian markets Investments to improve customer interface