

## Understanding Starbucks

September 2006



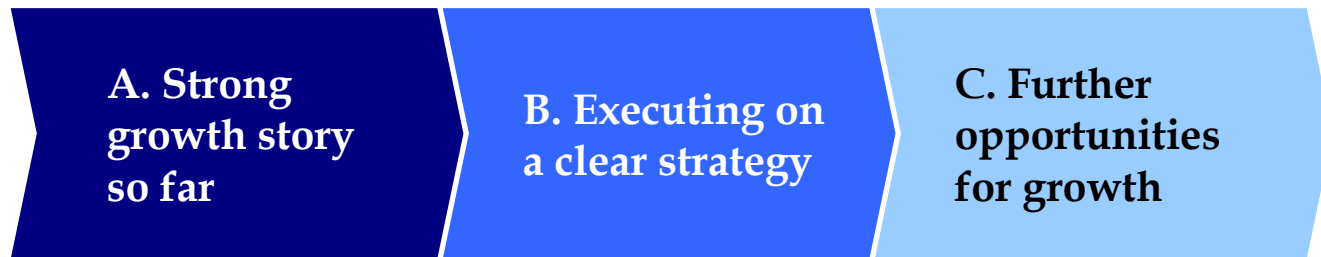
*This case study has been prepared by Tim Morris of Coriolis Research specifically for the Food Executive Program. It is designed to provide the basis for class discussion rather than to illustrate the effective or ineffective handling of a management situation.*

**“...this Starbuck seemed prepared to endure for long ages to come, and to endure always, as now; for be it Polar snow or torrid sun, like a patent chronometer, his interior vitality was warranted to do well in all climates.”** *Herman Melville, Moby Dick, 1851*

## DOCUMENT STRUCTURE

This document is structured in three parts

Document Structure



## DOCUMENT STRUCTURE - PART A

### Starbucks has had a strong growth story so far

Document Structure  
*(model)*

**A. Strong  
growth story  
so far**

## STARBUCKS TIME LINE

Starbucks has its origin in a single store started in Seattle in 1971; however, the current business was started in 1987 by Howard Schultz

### Starbucks Time line

(1966-2005)

- 1966 Dutch immigrant Alfred Peet opens a European-style coffee store in Berkeley California
- 1971 Jerry Baldwin, Zev Siegel & Gordon Bowker opened Starbucks store in Seattle, WA selling coffee beans – after having been students at U.C. Berkeley and buying coffee at Peet's; coffee comes from Peet's for first year
- 1982 Four Starbucks stores in Seattle, selling beans & coffee makers
- 1982 Howard Schultz hired as Marketing Manager from coffee packaging & equipment company Hammerplast
- 1984 Baldwin and others purchase Peet's Coffee (now 5 stores)
- 1984 Schultz inspired after a visit to Italy – the sixth store opens with an espresso bar
- 1986 Schultz frustrated with Starbucks leaves and opens Il Giornale an Italian espresso bar

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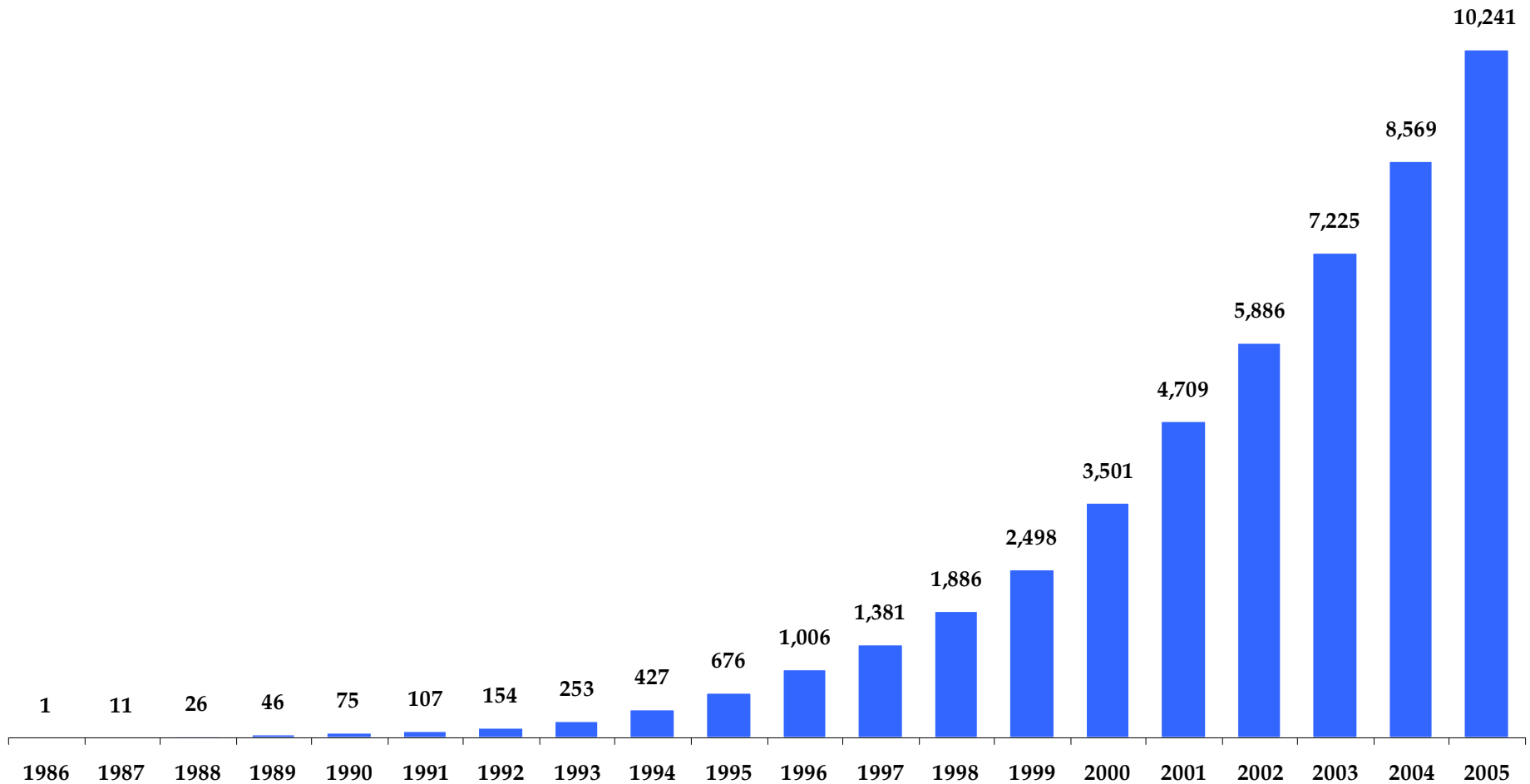
- 1987 Il Giornale acquires Starbucks for \$3.8m (but not Peet's) from Baldwin & others. Starbucks Corporation is formed with Howard Schultz as president and CEO – all stores rebranded with new logo and called Starbucks
- 1988 Develops a mail order catalogue
- 1987 Entered Chicago followed by Portland, Oregon
- 1991 Entered California
- 1991 Started employee stock options
- 1992 Starbucks goes public with IPO – with 165 stores
- 1994 Entered into agreement with Pepsi Co to distribute shelf-stable coffee-flavored beverages in bottles and cans
- 1996 First Starbucks outside North America in Tokyo, Japan
- 1998 Entered into supermarkets
- 1998 International expansion
- 1998 Entered New Zealand
- 2000 Entered Australia
- 2001 Entered Switzerland – the first Continental European store
- 2003 Starbucks purchases Seattle's Best Coffee and Torrefazione Italia from AFC Enterprises
- 2003 Starbucks has over 6,400 stores worldwide
- 2005 James (Jim) Donald takes over as new Starbucks CEO; Starbucks has 10,241 stores worldwide

# PHENOMENAL UNIT GROWTH

Starbucks store numbers have shown phenomenal growth

Total number of Starbucks stores

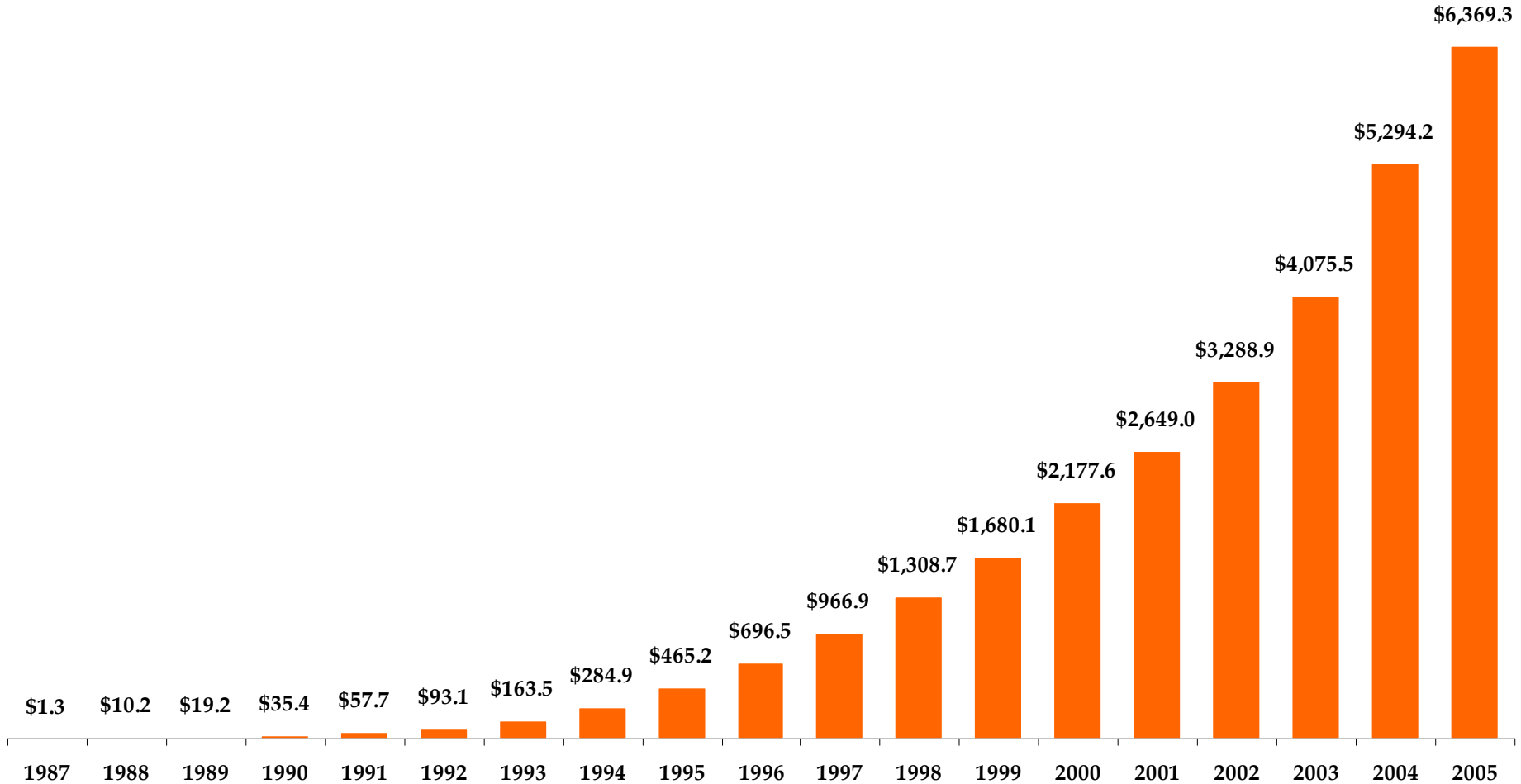
(units; actual; 1986-2005)



# PHENOMENAL SALES GROWTH

## Starbucks sales growth has also been phenomenal

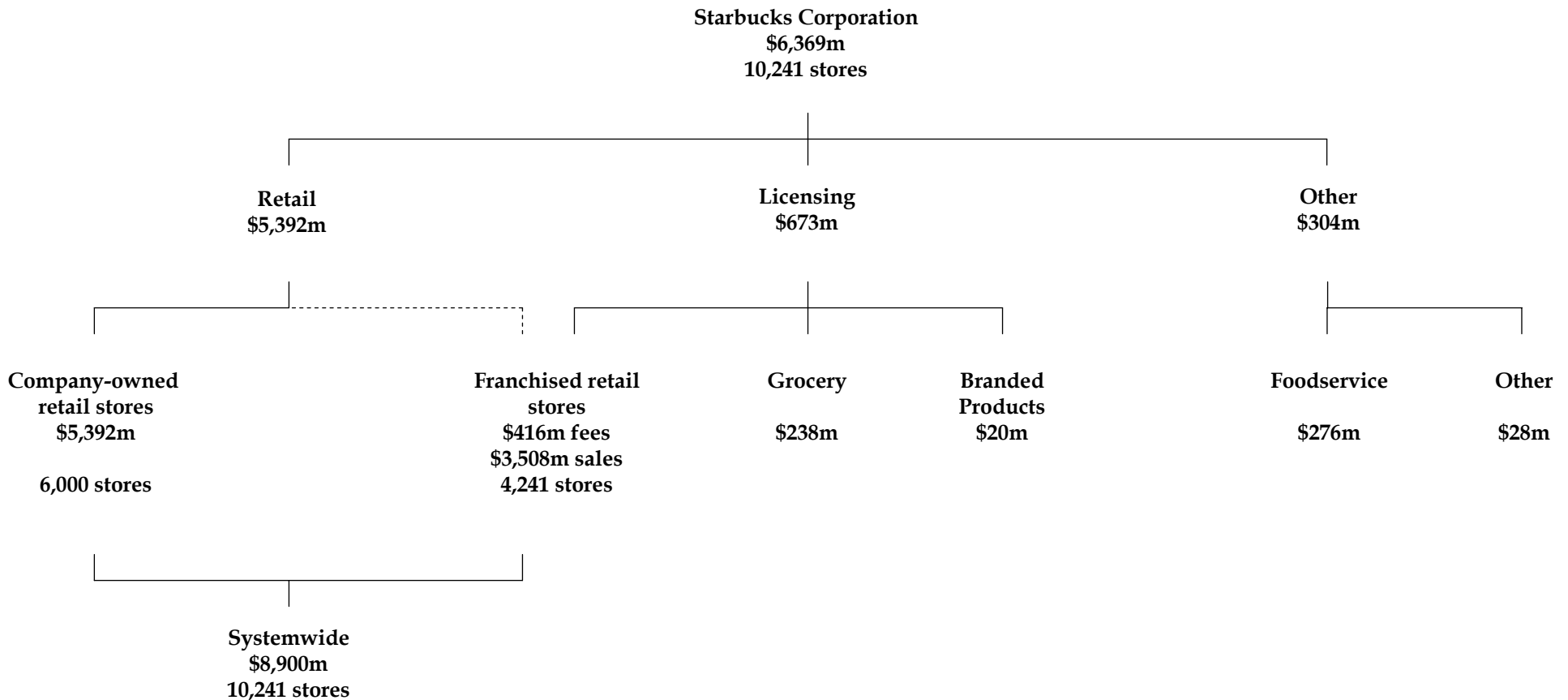
Starbucks group sales growth  
(US\$; millions; 1987-2005)



## MULTIPLE REVENUE STREAMS

Starbucks receives revenue from company-owned stores, franchised stores, licensed grocery products, foodservice and other ventures

Starbucks group structure  
(US\$; millions; 2005)





## DIVISIONAL ROLES

Starbucks various divisions are structured as follows

### Description of various Starbucks divisions

(US\$; millions; 2005)

Segment	Starbucks Revenue	# of units	Description
<b>Company-owned retail</b>	<b>\$5,392</b>	<b>6,000</b>	
- United States	\$4,539m	4,867	Company owned and operated retail stores in the United States
- International	\$852m	1,133	Company-owned and operated stores in Canada, UK, Thailand, Australia, Germany, Singapore, China, Chile & Ireland
<b>Franchised retail</b>	<b>\$416m</b>	<b>4,241</b>	
- United States		2,435	Stores franchised to supermarkets, contract caterers, airport foodservice operators, etc
- International		1,806	Stores franchised to a licensee on a country-level basis in 21 other countries
<b>Licensing</b>			
Licensed grocery	\$238	-	Starbucks-branded whole bean and ground coffee licensed to Kraft Foods
Licensed branded-products	\$20	-	Income from licensed various joint-ventures (beverages, ice-cream, etc)
<b>Other</b>			
Foodservice	\$276m	-	Sales to institutional foodservice companies that service business, industry, education and healthcare accounts, office coffee distributors, hotels, restaurants, airlines and other
Other	\$28m	-	Hear Music™ satellite radio, in-store wireless broadband, Starbucks stored-value card, Starbucks Visa and other initiatives
	<b>\$6,369m</b>	<b>10,241</b>	

## KEY COMPETITION

## Starbuck's is by far the largest chain coffee store operator in North America

## Profile of major North America-based coffee/coffee-related chains

(various; 2005)

	# of worldwide units	Systemwide Sales (2005)	Countries of operation	Ownership	Comments
Starbucks	10,241		38	Public (NYSE: STBX)	-
Dunkin' Donuts	4,815	\$3,854m	15	Private equity: Bain Capital, etc	Sold by Allied Domecq in 2005
Tim Horton's	2,801	\$3,720m	2	Public (NYSE: THI)	Wendy's spin-off IPO 2005
Daylight Donuts	463	?	10	Flour mill: Daylight Donut Flour Co.	No franchise fee
Cinnabon	629	\$216m	29	Private equity: Roark Capital	-
Einstein Bros. Bagels	424	\$363m	1	Private equity: New World Restaurant Group; 95% Greenlight Capital	Starbucks owned 25% of Noah's bagels, with rights to buy all, but sold shares instead
Manhattan Bagels	221				
Noah's Bagels	75				
Chesapeake Bagel Bakery	32				
New World Coffee	21				
Krispy Kreme	402	\$900m	7	Public (NYSE: KKD)	-
Diedrich Coffee Gloria Jean's Coffee People	201 +338	?	1 +20	Public (NASDAQ: DDRX) + Jareh International (AU)	Sold intl. franchise to 338 stores and brand and rights to Jareh Int. (AU franchisee) in Feb 2005
Caribou Coffee	416	\$198m	4	Public (NASDAQ: CBOU)	
Second Cup	375	?	4	Private	All stores in Canada
Bruegger's Bagels	249	\$150m	1	Private equity: Sun Capital Partners	Sold by founders in 2003
Winchell's Donuts	170	?	4	Private	
Peet's Coffee	118	\$145.7m	1	Public (NASDAQ: PEET)	
Tully's Coffee	110	\$58.2m	2	Private	Licensed brand to Tully's Japan
Coffee Bean & Tea Leaf	390	?	14	Private; CEO + investor group	Purchased by investors 1998
The Coffee Beanery	200+	?	4	Private	
Brewster's Coffee	154	?	2	Public (OTC: BAB)	Also bagel & muffin chains
Timothy's Coffee	130+	?	2	Private	Primarily Canada
Barnie's Coffee	100+	\$74.3m	6+	Private	Selling 56 stores to Starbucks

## KEY COMPETITION

Starbuck's is also the largest chain coffee store operator in the world

## Profile of major International coffee/coffee-related chains

(various; 2005)

	# of worldwide units	Systemwide Sales (2005)	Countries of operation	Ownership	Comments
<b>Starbucks</b>	10,241		38	Public (NYSE: STBX)	-
<b>Japan</b>					
Doutor Coffee	1,424	?	5+	Public (Tokyo: 9952)	Stores are franchised under multiple brands
Tully's Coffee Japan	330	?	Japan	Public (Japan)	Licensed from Tully's Coffee US
<b>United Kingdom</b>					
Costa Coffee	500	£143m	8+	Whitbread (London: WTB)	121 international; 1,000 by 2010
Caffé Nero	285	£70.1m	U.K.	Public (London: CFN)	
Coffee Republic	44	£17.6m	U.K.	Public (London: CFE)	Converting to deli-style
Madisons Coffee	19	?	U.K.	Private equity: Penta Capital	
<b>Europe</b>					
Tchibo Eduscho	900+	?	12		Primarily in Germany
Sigafredo Zanetti	300+	?	35+	Massimo Zanetti Beverage Group	Italy's #1 coffee roaster
Illycaffè	150+	?	20+		
<b>Other</b>					
Gloria Jean's	338	?	20	Jareh International (AU)	Bought intl. franchise to 338 stores and brand in Feb 2005
Café Coffee Day	198	?	India	Amalgamated Bean Coffee Traders	Roaster with franchised stores
Seattle's Best International	150	?	12	Private equity: Roark Capital	Non-U.S. stores only

## SET OFF A COFFEE REVOLUTION

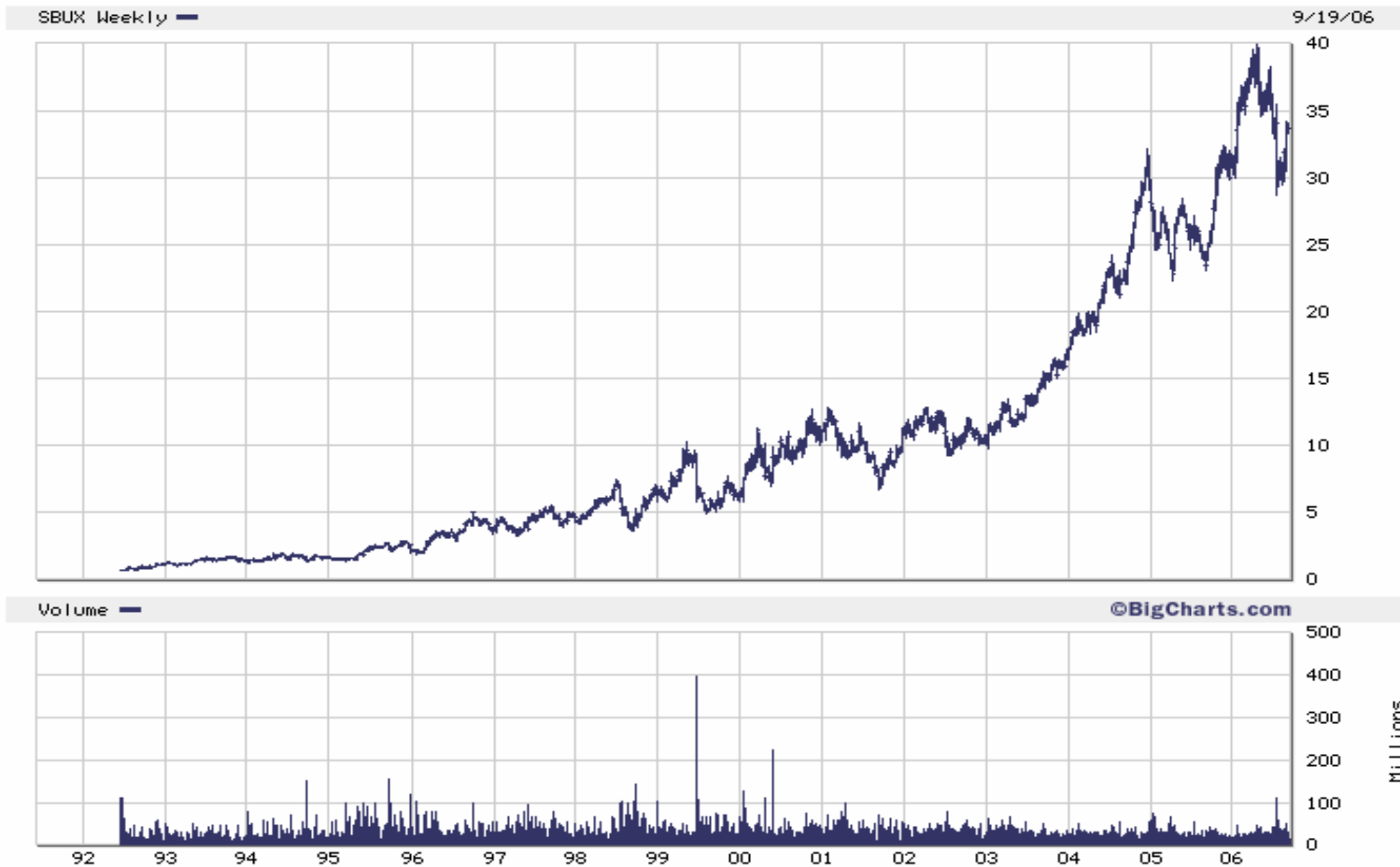
### Starbucks set off a coffee revolution

- **“Starbucks has created a new coffee revolution in the United States. For 20 years prior to 1990, coffee consumption was in a steep decline in the United States. By adding hot milk, lots of sugar, and a warm environment, Starbucks taught the American public to appreciate quality coffee while expanding the coffee category. Based on Starbucks’ success, consumption of premium coffees has risen at the expense of more traditional robusta-bean, non-premium coffees. In addition, it has allowed other competitors in the coffee category to improve their product offering, while increasing sales in other day-parts.”** *Howard Penney, analyst, Friedman, Billings Ramsey & Co., Feb 2005*
- **“The rapid rise of Starbucks over the past decade sparked a widespread domestic “java revolution,” which has resulted in a marked improvement in the quality of coffee offered by other foodservices firms as well as non-restaurants (gas stations, airlines, hotels, etc.).”** *Mark Kalinowski, analyst, Salomon Smith Barney, April 2000*

# STOCK PRICE

## Starbucks stock has been an excellent investment

Starbucks stock price performance  
(STBX; US\$; 1992-2006/9)



## DOCUMENT STRUCTURE - PART B

### Starbucks is executing on a clear strategy

#### Document Structure



## SEVEN PART STRATEGY

Starbucks' outlined a seven part strategy for growth in its 1991 prospectus - and by-and-large has stuck to it since

Starbucks' corporate strategy from IPO prospectus  
(1991)

Strategy	Details
1 Highest-quality coffee	Starbucks believes its standards for the selection, roasting and fresh delivery of Arabica coffee beans and beverages are among the highest in the coffee industry
2 Vertical integration	In order to manage costs and ensure compliance with the Company's rigorous standards of freshness, quality and consistency, the company controls its coffee sourcing, roasting, and retail sales. The company believes this vertical integration provides significant competitive advantages.
3 Customer service	Starbucks' goal is to develop customers who are "enthusiastically satisfied" every time they visit a Starbucks store. The Company depends on a high level of repeat business and views the quality of its customer interaction with employees as critical to its long-term success. Through its emphasis on training, personnel development, and equity incentives, the Company believes it attracts and retains well-qualified, highly motivated employees committed to providing superior levels of customer service.
4 Merchandising & marketing	The Company combines its merchandising strategy with its marketing programs to create and reinforce a distinctive brand image built on the quality of its coffees. In its retail stores, the Company incorporates extensive use of the Starbucks logo with innovative packaging, unique product presentation, and the sale of high-quality coffee-making equipment and accessories. Starbucks' aim is to be a source for comprehensive information about the origins and characteristics of coffees, and the preparation methods that result in the best coffee and espresso beverages.
5 Store design & atmosphere	Starbucks stores are designed to suggest a sense of sophistication and style that reinforce the Company's distinctive brand image. Stores are typically configured to accommodate a high volume of traffic, while retaining an inviting, casual atmosphere.
6 Store locations	Starbucks' site selection strategy is to cluster stores in high-traffic, high-visibility locations in each of its target markets in order to realize operating and marketing efficiencies and enhance brand awareness.
7 Expansion	Starbucks' retail expansion strategy is to increase its market share in existing markets and open stores in new markets where it believes it can become the leading specialty coffee retailer. To a lesser extent, the Company will continue to expand its specialty sales and direct mail business, and will selectively pursue other distribution channels.

## 1. HIGHEST QUALITY COFFEE

### Starbucks buys only premium coffee

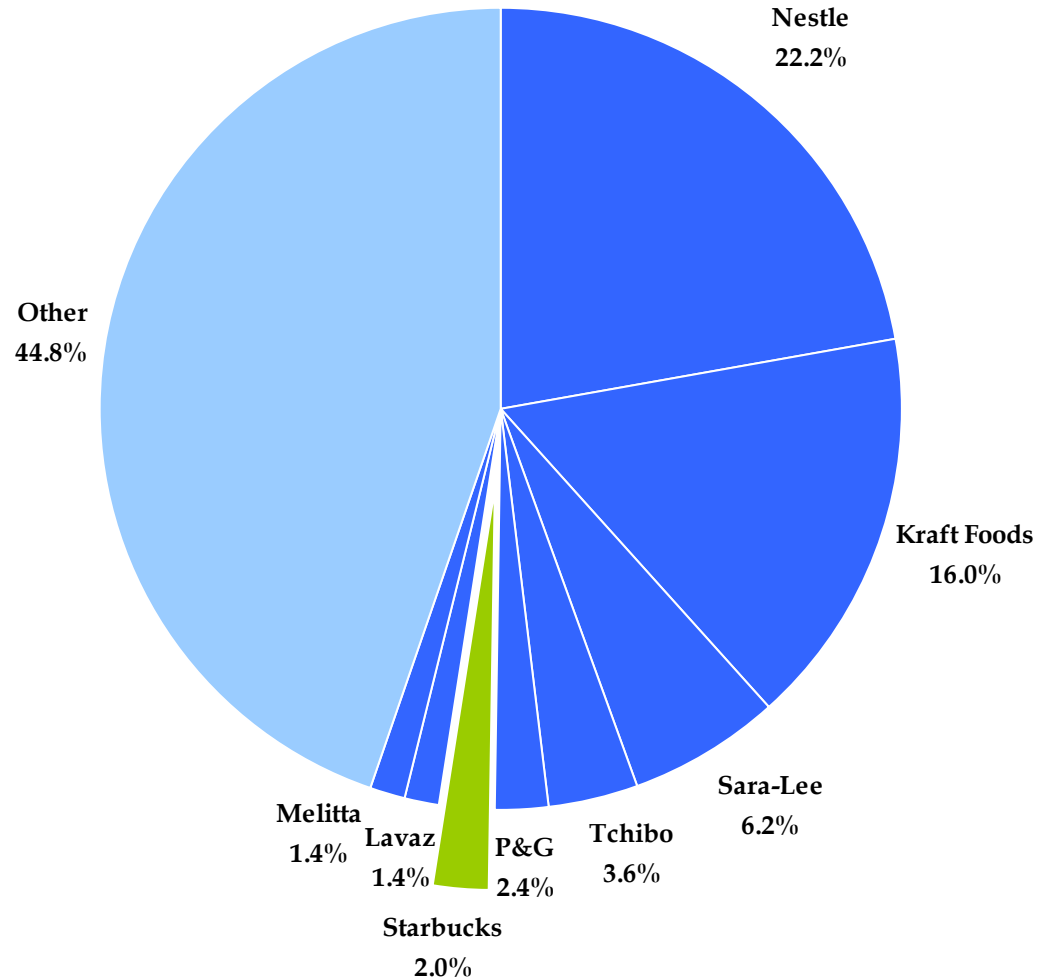
- “According to company reports, in 2005 Starbucks purchased 312 million pounds of coffee and paid an average price of \$1.28/lb, which is 23% higher than the New York “C” price. This implies Starbucks spent more than \$70 million over market prices for premium – but let’s put it in context: operating costs totaled more than \$5.6 billion last year. At 1.3% of total operating costs – quality comes first. Although the short-term cost is relatively low in terms of overall profits, the long-term benefits (think of it as health insurance for coffee beans) is an ensured supply. Starbucks stresses to its investors that the increased costs associated with social responsibility are not only morally and socially desirable for a company, but that the business itself will be helped in the future by ensuring a consistent and sustainable product.” *Marc Greenberg, analyst, Deutsche Bank, July 2006*
- “Dave Olsen, Starbucks' senior vice president for coffee, personally spearheaded Starbucks' efforts to secure top-notch coffee beans to supply the company's growing needs. He travelled regularly to coffee-producing countries – Colombia, Sumatra, Yemen, Antigua, Indonesia, Guatemala, New Guinea, Costa Rica, Sulawesi, Papua New Guinea, Kenya, Ethiopia, Java – building relationships with growers and exporters, checking on agricultural conditions and crop yields, and searching out varieties and sources that would meet Starbucks' exacting standards of quality and flavor. Starbucks controls its coffee purchasing, roasting and packaging, and the distribution of coffee to its retail stores. The Company purchases green coffee beans from coffee-producing regions around the world and custom roasts them to its exacting standards for its many blends and single origin coffees. The supply and price of coffee are subject to significant volatility. Although most coffee trades in the commodity market, coffee of the quality sought by the Company tends to trade on a negotiated basis at a substantial premium above commodity coffee prices, depending upon the supply and demand at the time of purchase.” *Starbucks, 2005, 10k*



# 1. HIGHEST QUALITY COFFEE - A MAJOR BUYER

Starbucks buys about 2% of global coffee production

Major global buyers of coffee  
(% of volume; 2005)

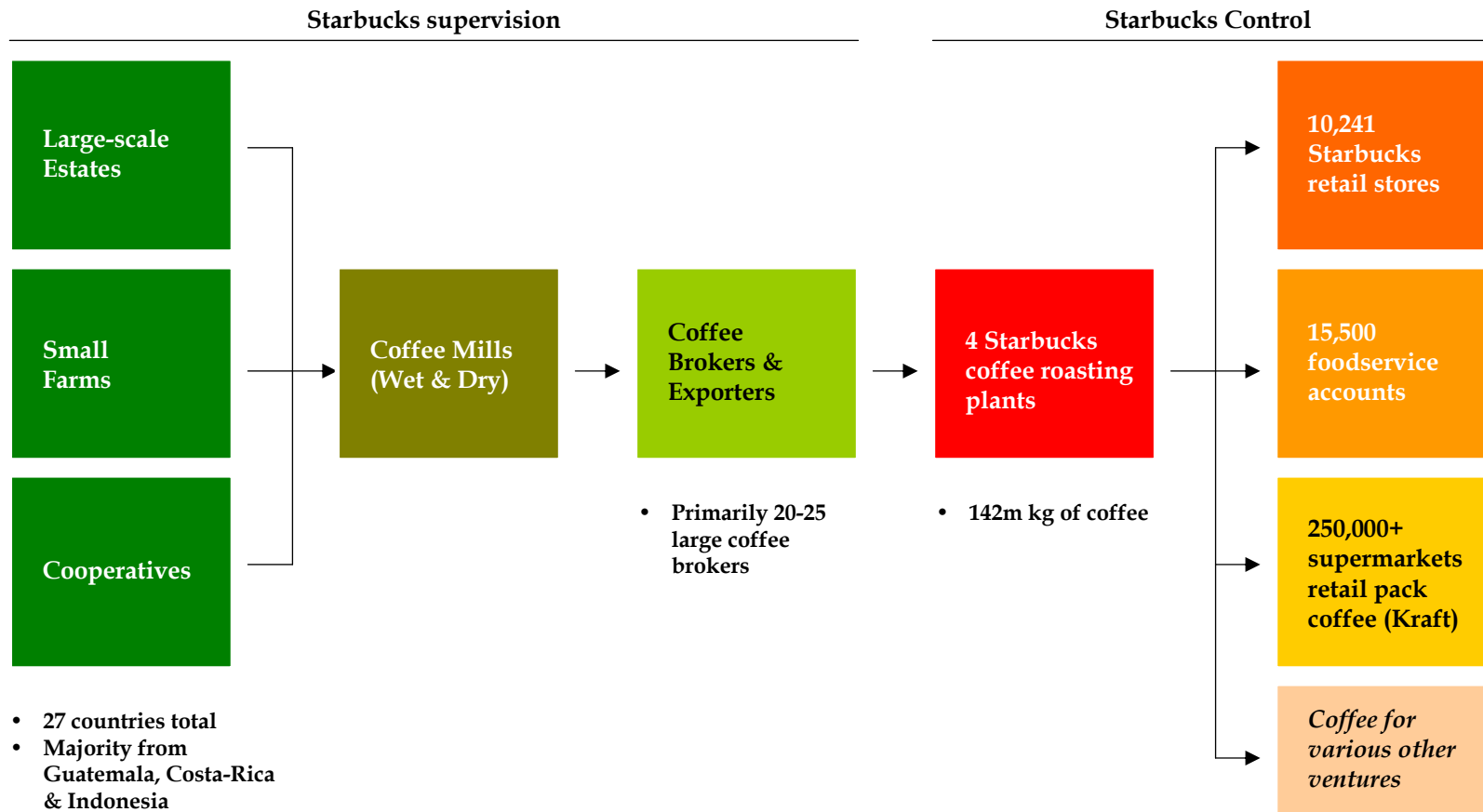


## 2. VERTICAL INTEGRATION

### Starbucks keeps tight control over its supply chain and retail stores

#### Structure of Starbucks supply chain

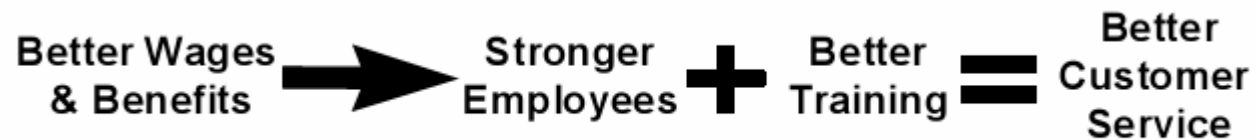
(% of volume; 2005)



### 3. CUSTOMER SERVICE

Starbucks believes superior customer service comes from having well paid, well trained employees

Starbucks customer service concept  
(model)



### 3. CUSTOMER SERVICE – TREAT EMPLOYEES WELL

#### Starbucks treats its employees well

- **“I believe very strongly that the success of our company has been achieved because of the relationship with our people... ” Howard Schultz, CEO, Starbucks, 2003**
- **“My dad was a blue-collar worker. He didn’t have health insurance or benefits, and I saw firsthand the debilitating effect that had on him and on our family. I decided if I was ever in the position to make a contribution to others in that way, I would... The desire to scrimp on these essentials helps reinforce the sense of mediocrity that seems into many companies. Without them, people don’t feel financially or spiritually tied to their jobs... We’re building a national company by creating pride in – and a stake in – the outcome of our labor.” Howard Schultz, CEO, Starbucks, 1993**
- **Core strategy to win employee loyalty and commitment to the company’s mission.**
  - **Extensive health care benefits to full and part-time workers, including preventive care, crisis counselling, dental care, eye care, mental health care, and treatment for chemical dependency.**
  - **A stock option plan for all employees – “Bean Stock”**
  - **Store employees paid well above the minimum wage**
  - **Employees were also encouraged to speak their minds without fear of retribution from upper management.**
- **“Better benefits attract good people and keep them longer. Schultz’s rationale was that if you treat your employees well, they will treat your customers well. As a result Starbucks had low staff turnover – 65% compared to the industry rate ranging from 150 to 400 percent a year. Every partner/barista hired for a retail job in a Starbucks store received at least 24 hours training in the first two to four weeks. Training aimed to perfect the quality of the coffee and the customer experience. Schultz said Starbucks expects to spend about \$200 million this year for health care for its 80,000 U.S. employees – more than the total amount it spends on green coffee from Africa, Indonesia and other countries.” Associated Press, Sept 2005**
- **“Morale is very high in my store among the staff. I’ve worked for a lot of companies, but I’ve never seen this level of respect. It’s a company that’s very true to its workers, and it shows. Our customers always comment that we’re happy and having fun. In fact, a lot of people ask if they can work here.” Starbucks store manager**

### 3. CUSTOMER SERVICE - STOCK OPTIONS

#### All employees with the company for more than six months qualify for stock options

- **“In October 1991, the Bean Stock program was unveiled, in which everyone who has worked at least six months for the company (including part-time employees) were eligible for stock options. These revolutionary practices helped to keep employee turnover at just one-half to one-third of the restaurant industry’s average. To this day, Starbucks’ turnover rate remains one of the lowest in the sector.”** *Mark Kalinowski, analyst, Salomon Smith Barney, April 2000*

### 3. CUSTOMER SERVICE - CUSTOMER LOYALTY

**As a result of good customer service, Starbucks' achieves strong customer loyalty**

- **"We believe Starbucks' brand cachet gives it an enviable position as "simply the best" in customers' eyes. The average Starbucks customer visits an outlet 18 times per month – testament to the loyalty the brand engenders. We believe the company's clientele associates the Starbucks brand with quality, great customer service, and a pleasant, upscale overall experience. We are aware of very few other large-scale businesses – in any industry – that consumers tend to patronize more than every other day, on average. This loyalty leads us to believe that the lifecycle of the Starbucks concept could far exceed the restaurant industry average. To date, the company has never posted a month with flat or down same-store sales growth." Mark Kalinowski, analyst, Salomon Smith Barney, April 2000**

### 3. CUSTOMER SERVICE - MEASURE CUSTOMER SATISFACTION

Starbucks' constantly monitors customer service and satisfaction through its "Snapshot" mystery shopper program

- "A further encouraging sign is the rising "mystery shopper" scores earned by the firm's retail outlets. The mystery shopper program – termed "Snapshot" – encourages selected shoppers to rate items such as the outside store environment, the wait in line, friendliness and knowledge of the barista (person behind the counter), food and beverage quality, store cleanliness, and merchandise quality and layout." *Mark Kalinowski, analyst, Salomon Smith Barney, April 2000*

## 4. MERCHANDISING & MARKETING

### Starbucks works hard to clearly and consistently reinforce and build its brand image

- **“The Company combines its merchandising strategy with its marketing programs to create and reinforce a distinctive brand image for its coffees. The Company's merchandising strategy is reflected in its product mix, product pricing, and sale and educational materials.”** *Starbucks 10K 1996*
- **“Educating customers about specialty coffee is an important element of Starbucks’ merchandising strategy. Starbucks’ store employees are trained to be knowledgeable and conversant in the qualitative aspects of coffee, and each store provides educational booklets and materials to allow customers to understand the differences among each of Starbucks’ blends and varietals as well as the Company’s coffee and those offered by others. Point-of-sale materials are designed to entertain and inform the customers about the unique qualities of Starbucks’ coffees, and to reinforce Starbucks’ high-quality image.”** *Starbucks Prospectus 1992*



## 5. STORE DESIGN & ATMOSPHERE

**Stores are designed to be one of three places where customers relax and feel comfortable – their home, their work and Starbucks**

- **The CEO's vision: "An authentic coffee experience that conveyed the artistry of espresso making, a place to think and imagine, a spot where people could gather and talk over a great cup of coffee, a comforting refuge that provided a sense of community, a third place for people to congregate beyond work or the home, a place that welcomed people and rewarded them for coming, and a layout that could accommodate both fast service and quiet moments." *Howard Schultz, CEO, Starbucks, 1995***
- **"The Company's retail goal is to become the leading retailer and brand of coffee in each of its target markets by selling the finest quality coffee and related products and by providing each customer a unique Starbucks Experience. The Starbucks Experience, or third place experience, after home and work, is built upon superior customer service as well as clean and well-maintained Company-operated retail stores that reflect the personalities of the communities in which they operate, thereby building a high degree of customer loyalty." *Starbucks 10k, 2005***
- **"Starbucks designs its stores to suggest a sense of sophistication and style, and hopes each store will become a neighborhood gathering place. The company designs each of its stores in-house and uses high-quality building materials and fixtures to reinforce an upscale brand image. Most stores are configured to accommodate a high volume of traffic, while retaining an inviting, casual atmosphere." *Starbucks Prospectus 1992***
- **"To keep its image fresh and fashionable, Starbucks has designers and architects in-house. At headquarters, designers examine palettes of soft-colored tiles and test the angle of banquette seat backs." *Business Week, Oct 1994***

## 6. STORE LOCATIONS

### Starbucks has strong capabilities around selecting the best site for a store

- “Starbucks retail stores are typically located in high-traffic, high-visibility locations. Because the Company can vary the size and format, its stores are located in or near a variety of settings, including downtown and suburban retail centers, office buildings and university campuses. While the Company selectively locates stores in shopping malls, it focuses on locations that provide convenient access for pedestrians and drivers. With the flexibility in store size and format, the Company also locates retail stores in select rural and off-highway locations to serve a broader array of customers outside major metropolitan markets and further expand brand awareness. To provide a greater degree of access and convenience for non-pedestrian customers, the Company has increased development of drive-thru retail stores. At the end of fiscal 2005, the Company operated approximately 1,100 drive-thru locations.” *Starbucks 10k 2005*

## 7. RAPID EXPANSION

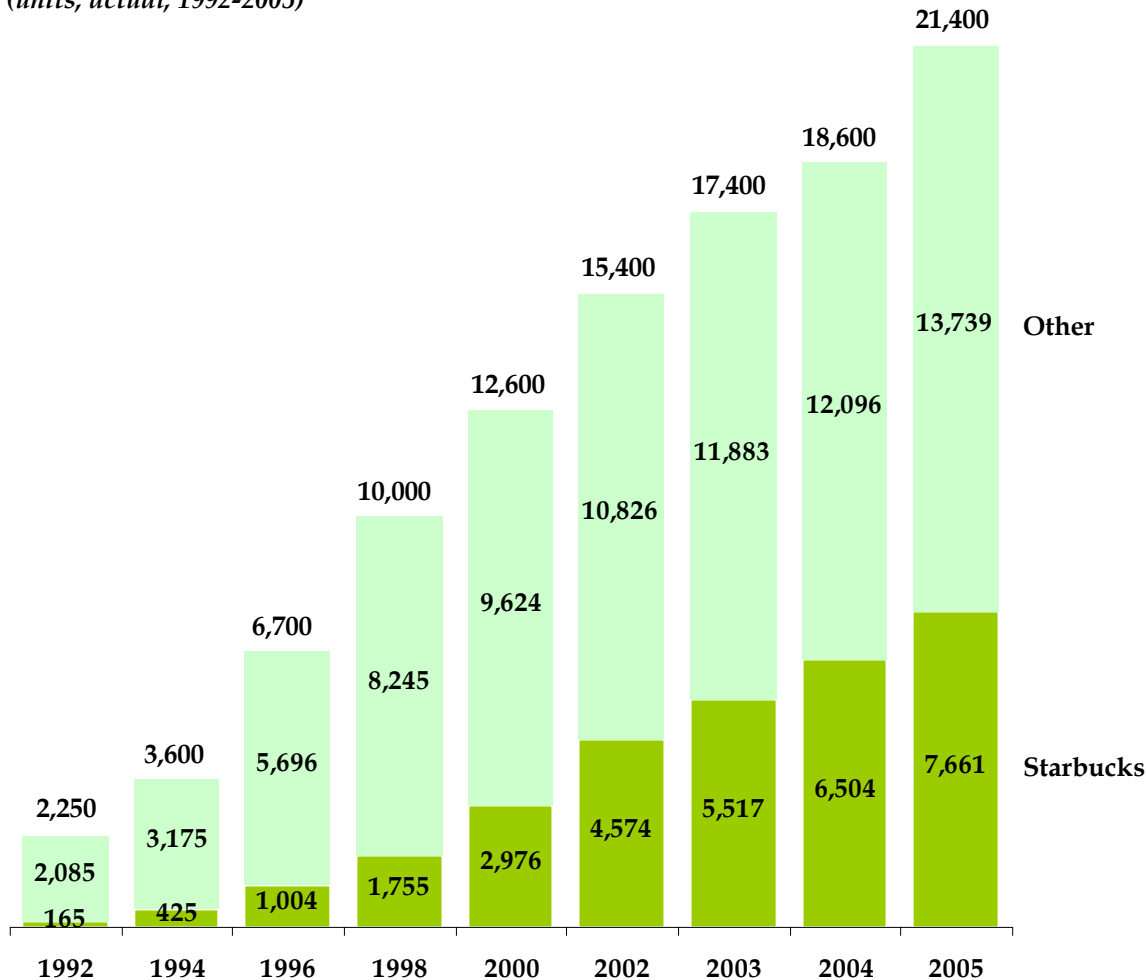
**Right from the start Starbucks intended to dominate the United States coffee market while maintaining strong control and discipline**

- **“If we are going to build a 100-story skyscraper, we have to build a foundation strong enough to sustain 100 stories... I believe in the adage: Hire people smarter than you are and get out of their way.” Howard Schultz, CEO, Starbucks, 1994**
- **“The strategy was to open only company-owned stores; franchising was avoided so as to keep the company in full control of the quality of its products and the character and location of its stores... Starbucks’ used geographic Expansion of zones based around city “hubs” which had favorable demographic profiles and could also be serviced and supported by the company's operations infrastructure. Teams of professionals were located in hub cities to support the goal of opening 20 or more stores in the hub in the first two years. Once stores blanketed the hub, then additional stores were opened in smaller, surrounding "spoke" areas in the region.” Howard Schultz, CEO, Starbucks, 1994**
- **“Schultz envisions a nation of Starbucks’ zealots, their coffee palates as discerning as wine connoisseurs. He sees a Starbucks in every North American neighborhood, anchoring each community like an Irish pub, and a pound of Starbucks’ House Blend in every kitchen. In short, Howard Schultz wants the coffee craze he created in Seattle to extend across the nation.” Success magazine, April 1995**

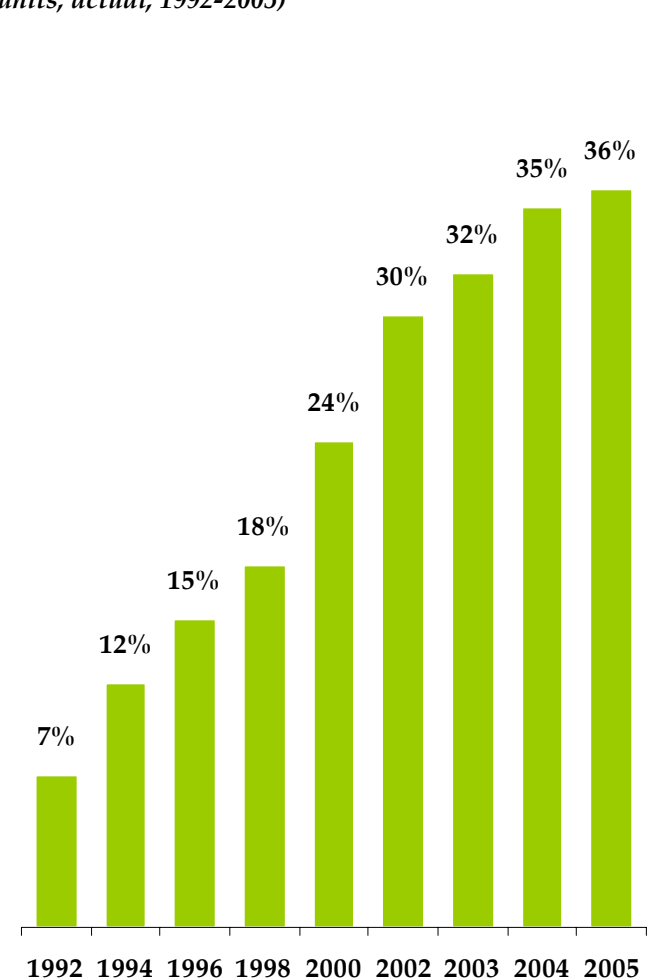
## 7. RAPID EXPANSION - DEVELOPED DOMINANT POSITION

By growing rapidly, Starbucks has developed a dominant position in the United States market

Specialty Coffee stores in the United States  
(units; actual; 1992-2005)



Starbucks as a % of US specialty coffee stores  
(units; actual; 1992-2005)



## 7. RAPID EXPANSION – ACQUISITIONS IMPORTANT

Strategic bolt-on acquisitions have been an important growth vehicle for Starbucks at certain points during its US growth

Starbucks' United States retail coffee outlet acquisitions  
(various; 1987-2006)

Date	Target	Price	Location	# of outlets	Description
1987	Starbucks	\$3.8m	Seattle	7	Il Giornale (3 stores) acquires Starbucks. Starbucks Corporation is formed with Howard Schultz as president and CEO – all stores rebranded with new logo and called Starbucks
1994	The Coffee Connections	\$20.4m	East Coast		East Coast coffee roaster/retailer; all converted
1999	Pasqua Coffee	\$9m	San Francisco Los Angeles New York	48	Regional roaster and retailer of specialty coffee with 48 retail outlets, 8 licensed airport locations, a coffee roasting plant, three commissaries and two bakeries; all converted
2003	Seattle Coffee Company	\$72m	United States	146	Seattle's Best Coffee and Torrefazione Italia chains from AFC 70 company-owned; 76 franchised
2006	Barnie's Coffee	n/a	Florida	56	Buying 56 Barnie's outlets, mostly in Florida
2006	Diedrich Coffee	\$13.5m	National	40	All Diedrich company-owned Diedrich and Coffee People stores; ; does not include wholesale roasting or franchised stores

## 7. RAPID EXPANSION – COMPETITORS DIDN'T DELIVER

### Starbucks' US competitors have failed to deliver

Specialty coffee chain growth in the US: Starbucks vs leading competitors  
(units; actual; 1995 v 2005)

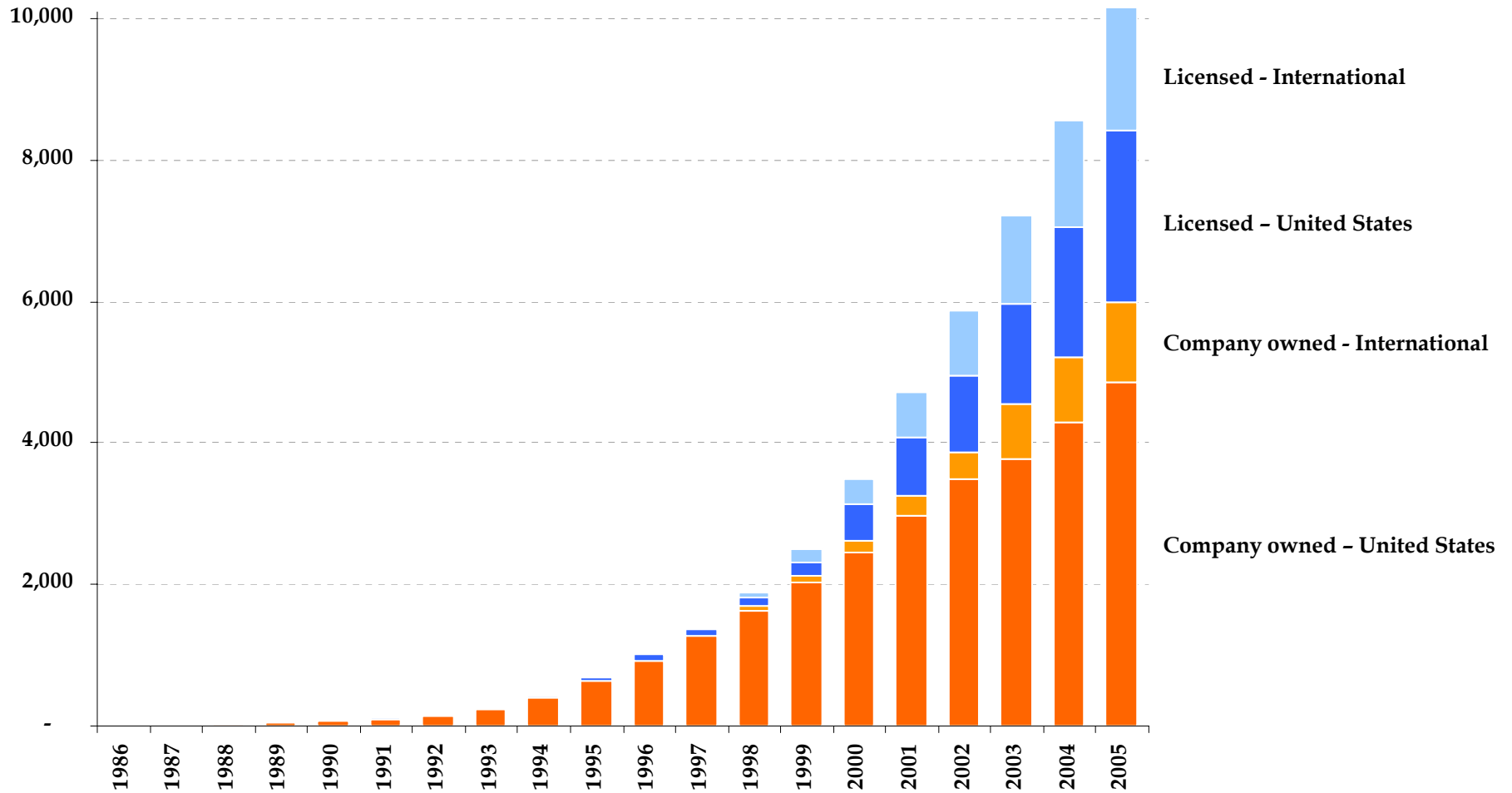
	# of units		Absolute Change	CAGR (95-05)	
	1995	2005			
Starbucks	682	7,661	+ 6,979	27%	
Gloria Jeans	230	147	(83)	-4%	
The Coffee Beanery	157	200	+43	2%	
Barnie's Coffee	86	100	+14	2%	
Timothy's World Coffee	70	130	+60	6%	
New World Coffee	27	21	(6)	-2%	
Seattle's Best Coffee	24	*	*	*	Sold to Starbucks 2003
Caribou Coffee	20	322	+302	32%	
Coffee People	19	*	*	*	Sold to Starbucks 2006
Other	3,685	12,794	+9,109	13%	
<b>Total</b>	<b>5,000</b>	<b>21,400</b>	<b>+16,400</b>	<b>16%</b>	

Note: Uses only specialty-coffee focused competitors, not donut-based chains which are not included by the SCA in industry data

## 7. RAPID EXPANSION - GROWTH OF LICENSING

Starbucks unit growth is being helped by its increasing use of licensing

**Total number of Starbucks stores by ownership and location**  
(units; actual; 1986-2005)

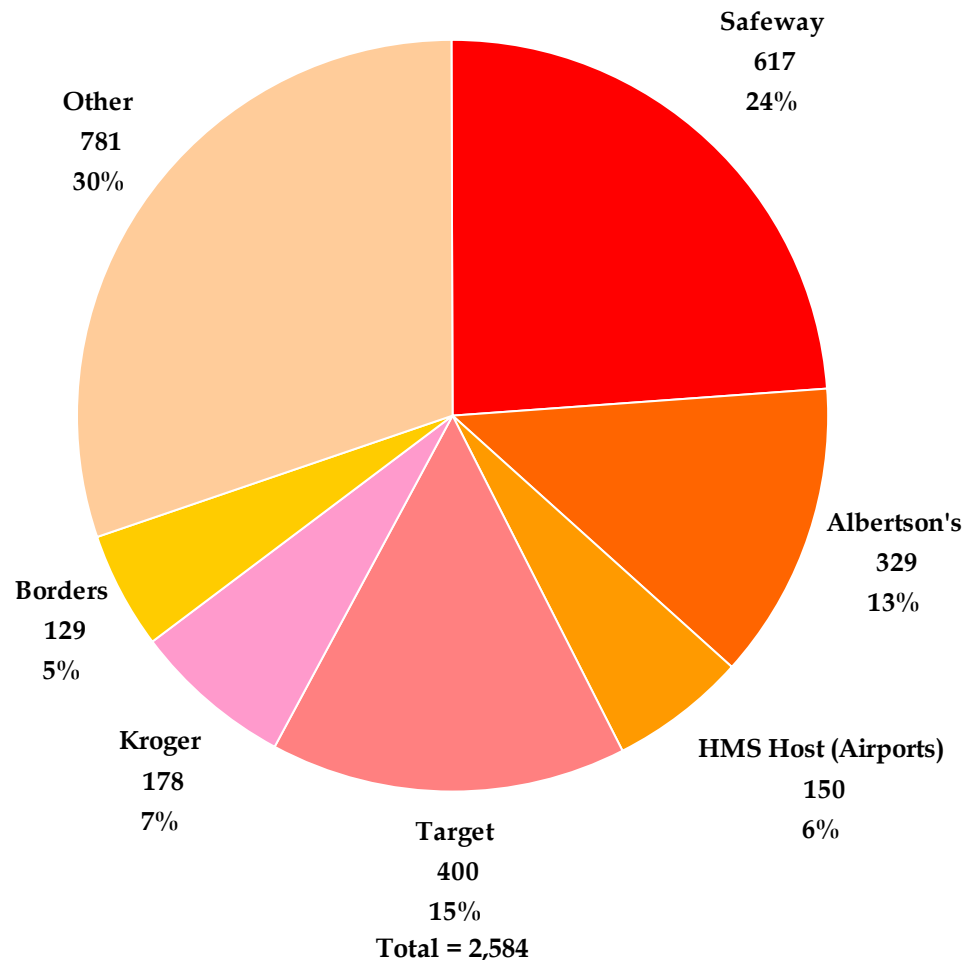


## 7. RAPID EXPANSION – LICENSEES ARE CHAINS

Starbucks’ United States licensees are major chain store operators able to “bolt-on” a Starbucks to an existing location, not individual franchisees

Breakdown of Starbucks’ licensees in the United States

(units; actual; 2005)





## 7. RAPID EXPANSION – POSITIVES & NEGATIVES TO LICENSEES

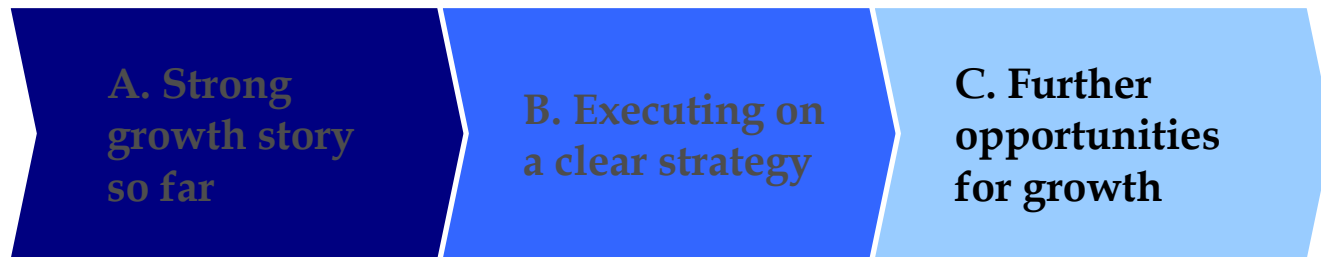
### Licensing has both positives and negatives for Starbucks

- “In general, selling to licensees is a lower-margin endeavor compared with opening company outlets, although it requires much less capital. The company provides products (mostly coffee) to the licensed sites, and also gains a per-unit development fee (with the exception of the Barnes & Noble locations). In addition, we believe Starbucks receives a blended license fee in the middle- to high-end of the 2%-7% industry norm – this figure represents a percentage of gross sales.” *Mark Kalinowski, analyst, Salomon Smith Barney, April 2000*
- “In its licensed retail store operations, the Company leverages the expertise of its local partners and shares Starbucks operating and store development experience. Licensee partners are typically master concessionaires, which can provide improved access to desirable retail space, or prominent retailers with in-depth market knowledge and access. As part of these arrangements, Starbucks receives license fees and royalties and sells coffee, tea, CDs and related products for resale in licensed locations. Employees working in licensed retail locations are required to follow Starbucks detailed store operating procedures and attend training classes similar to those given to Company-operated store managers and employees.” *Starbucks 10k 2005*
- “While the profit dollar contribution of the licensed business is only about one quarter of a similar company-owned store, it has a strong positive contribution to profit margins given the high flow through of licensed fees. As illustrated below, the rapid increase in licensed units has provided a strong uptick in licensed revenues and has been one of the keys to U.S. margin expansion in recent quarters.” *John Glass, analyst, CIBC, March 2006*
- “The rapid growth in licensed units raises the issue of cannibalization of company-owned units. While this is possible to some degree, these fears are generally overblown, in our view. Among the reasons:
  - Most licensed units are in captive locations – airports and supermarkets – and therefore don’t directly compete with traditional company-owned units.
  - Licensed locations in supermarkets generate substantially lower volumes than do company-owned units, and therefore their market share is much lower than their ‘unit share’.” *John Glass, analyst, CIBC, June 2004*

## DOCUMENT STRUCTURE - PART C

### Starbucks still has further opportunities for growth

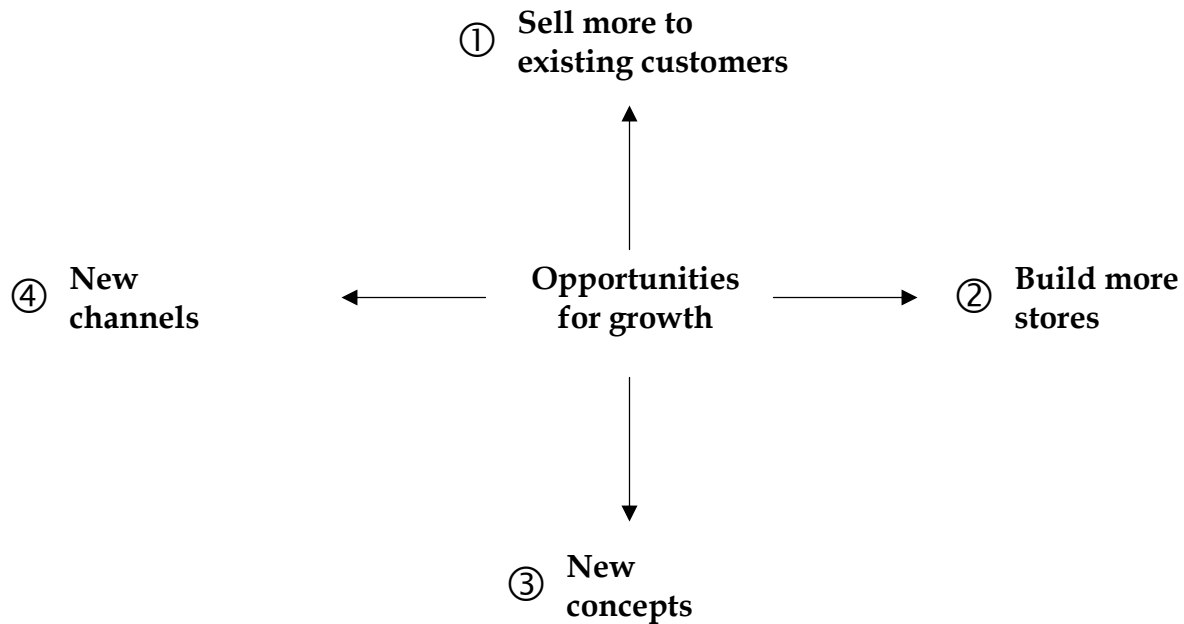
#### Document Structure



## FOUR OPPORTUNITIES FOR GROWTH

Our research indicates Starbucks has four major opportunities for future growth

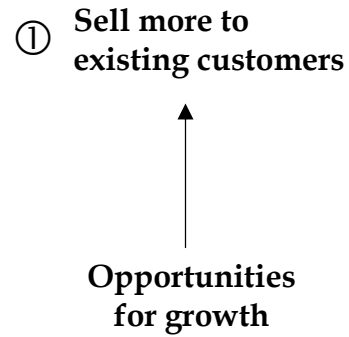
Starbucks four opportunities for growth  
(model)



# 1. MORE TO EXISTING CUSTOMERS

Starbucks first opportunity for growth is to sell more to its existing customers

Starbucks four opportunities for growth  
(model)

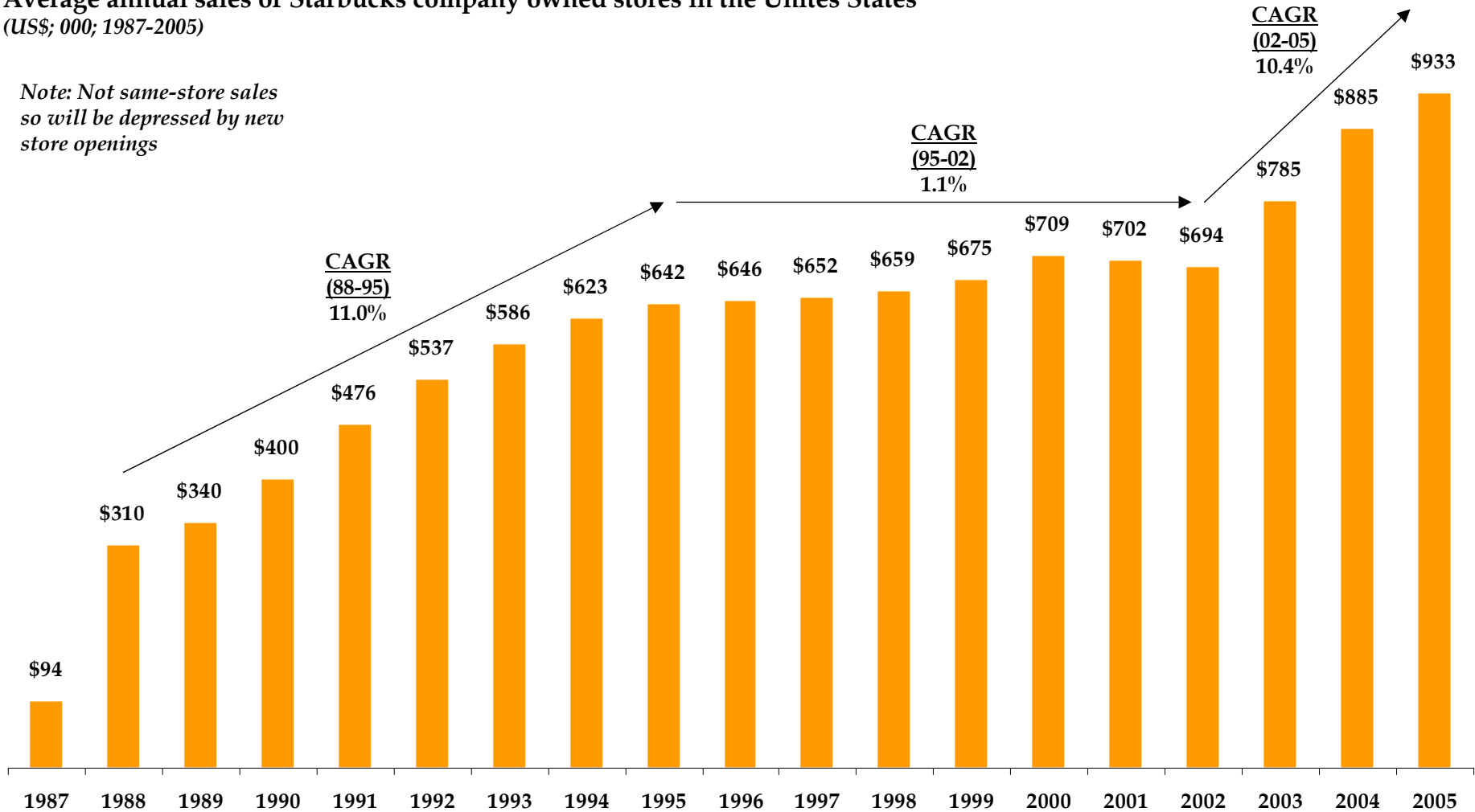


# AVERAGE STORE SALES GROWTH

## Starbucks has managed to grow average store turnover

Average annual sales of Starbucks company owned stores in the United States  
(US\$; 000; 1987-2005)

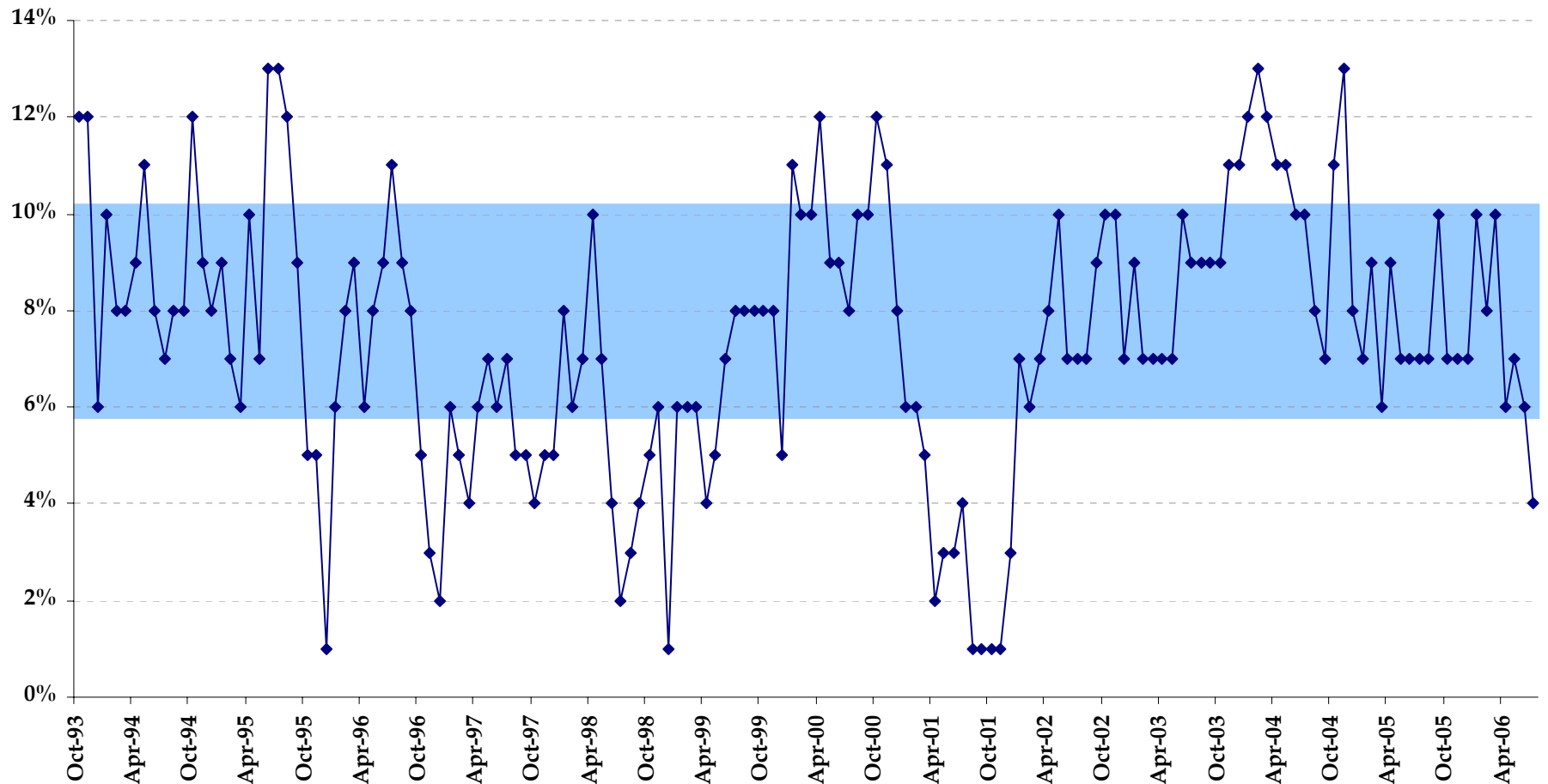
Note: Not same-store sales  
so will be depressed by new  
store openings



## STRONG SAME STORE SALES GROWTH

Starbucks has generally delivered on strong same-store sales growth - in the 6-8% range - since its IPO

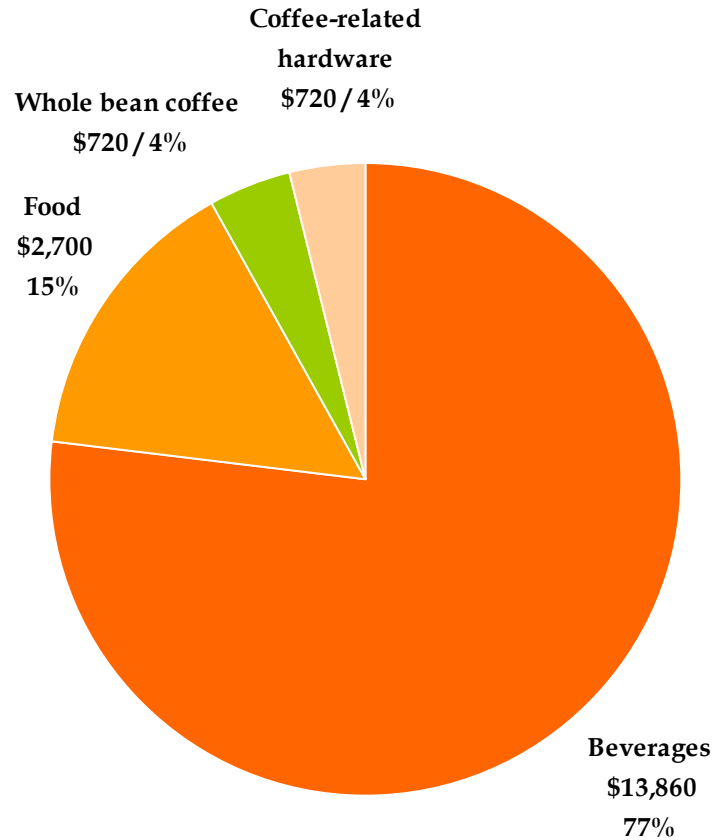
Monthly same store sales growth of US company owned stores  
 (% change; actual; 1993-2006)



## BEVERAGES DOMINATE

The average Starbucks store has a turnover of \$80,000 per week, 77% of which is beverages

Average weekly Starbucks sales mix in US company owned stores  
(US\$; % of sales; 2005)

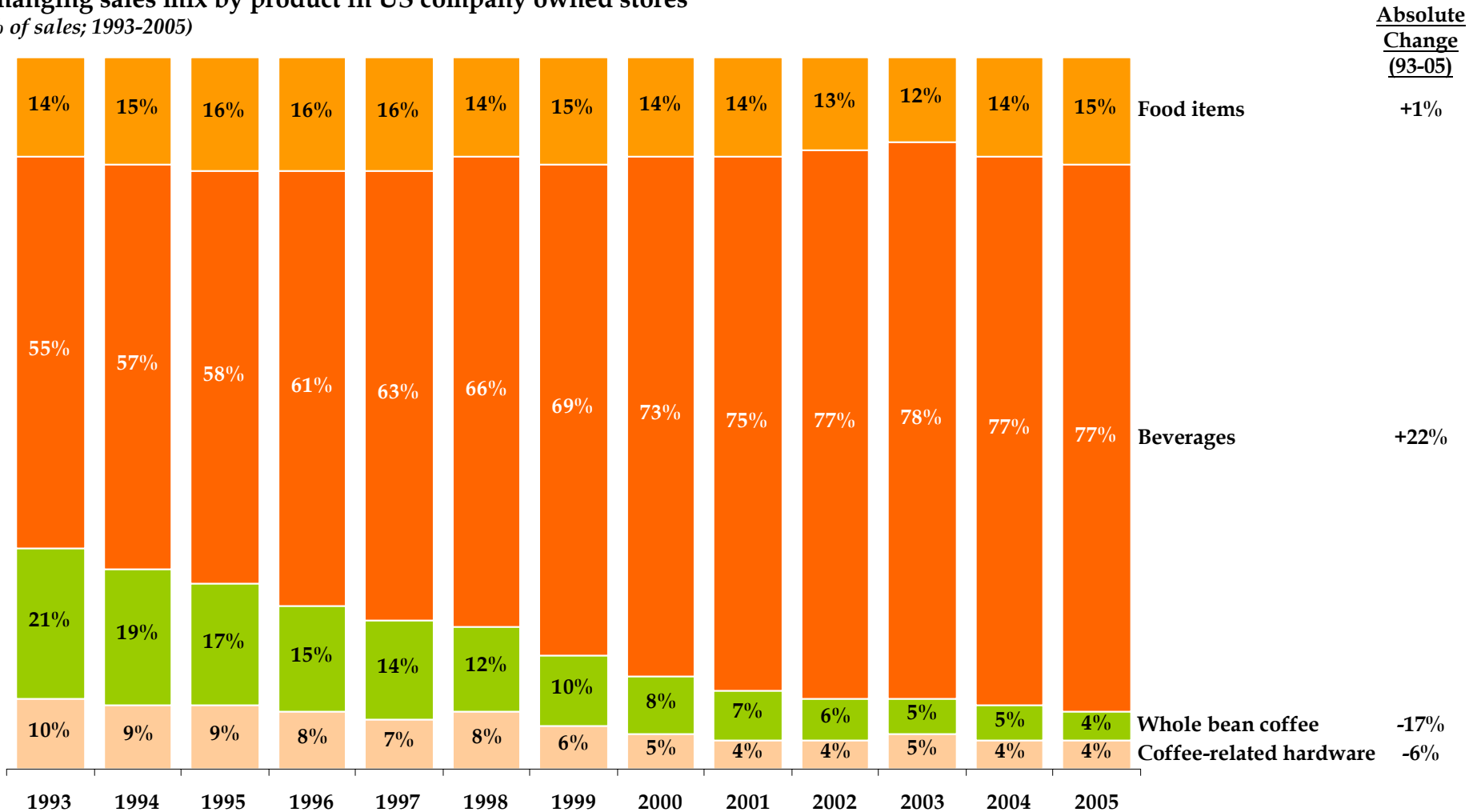


Total = \$80,000/week

# BEVERAGES DRIVING GROWTH

Beverages are increasing their share of the mix and thus driving growth

Changing sales mix by product in US company owned stores  
(% of sales; 1993-2005)





## MORNING DAY-PART FOCUS

### Starbucks has struggled to expand beyond its morning day-part

- **“There is room for better throughput and better utilization of non-A.M. day-parts, particularly, with better positioned food products that do not increase operational complexity or diminish speed of service. On this subject, we believe the “grab and go” tests have particular merit. The company has identified “sweet spots” where they believe they can improve sales with introduction of additional products, particularly the noon to 2:00 p.m. period (just 11.4% of retail sales currently), and the late night 7:00 p.m. to 10:00 p.m. period which represents just 10.5% of sales.”** *Scott Ackerman, analyst, Piper Jaffray, Dec 1998*
- **“Starbucks continues to seek to expand its day-parts. More than 50% of the company’s sales are made before noon, giving it significant capacity in the afternoon and evening to expand its business. The company’s rollout of lunch is one way it seeks to drive the afternoon day-part. Starbucks also rolled out a larger dessert line, as well as Chantico, a gourmet chocolate drink, in 2005 to drive the evening day-part as well. Chantico was recently discontinued. Thus far, Starbucks has not been able to meaningfully shift the day-part mix, but it is something it continues to work on.”** *Ashley Reed Woodruff, analyst, Bear Stearns, March 2006*
- **“Starbucks’ revenues by daypart are most heavily skewed toward the morning, with about 40% of sales coming before 11 a.m. We believe the largest opportunities are for lunch – historically a slower time of day for Starbucks.”** *Mark Kalinowski, analyst, Salomon Smith Barney, April 2000*
- **“Historically, Starbucks has been unable to change its day-part mix of sales... Considering Starbucks’ historical inability to change its day-part mix of sales, speed of service has become increasingly important, as it governs the total sales potential for a concept’s stores. Starbucks has focused on improving speed of service through training, technology, and process improvement. Technology that has recently been considered includes automatic espresso machines, point-of-sale technology... We believe that this will be the critical metric to watch to forecast same-store sales growth.”** *Howard Penney, analyst, Friedman, Billings Ramsey & Co., Feb 2005*

## RANGE EXTENSION/IMPROVEMENT

Starbucks has a number of opportunities to extend and improve its range

Range extension opportunities to increase same-store sales  
(model)

	Objective of range	Challenges
A. New beverage products	Attract new customers Generate excitement (e.g. seasonal)	- Developing new variants that cut through the clutter - Increasing complexity for marginal gains
B. Better food	Improve food offer	
- Sandwiches	Offer sandwiches, either pre-prepared or made-on-site	- Increased spoilage - Increased labor
- Cooked	Expand into short-order meals prepared on site	- <i>as above plus</i> - Need a larger box to accommodate kitchen
C. Music	Leverage and expand existing in-store music and CD program	- Space required for displays and inventory - Inventory requirements (unless digital) - Unclear point-of-difference v. Apple/iTunes
D. Other	various	- True growth engine or management distraction?

## A. NEW BEVERAGE PRODUCTS

### Starbucks constantly develops and launches new beverage products

#### Starbucks' new beverage products launched (1995-2006)

Year	Product	
1995	Frappuccino®	Icy, creamy low fat beverage
1995	Infusia™	Range of teas; didn't really work; later acquired Tazo Tea
1997	Venti	New larger 20 oz size beverage cup; later raised to 24 oz
1997	Power Frappuccino™	Frappuccino that is packed with protein, carbohydrates and a healthy boost of 12 essential vitamins geared towards the health-conscious consumer
1997	Chai Tea Latte	Combination of black teas, exotic spices, honey and milk
1997	Starbucks Barista™	Home espresso machine with portafilter system that accomodates both ground coffee and Starbucks new "espresso pods"
1998	Milder Dimensions™	Four blends with a lighter roasted, milder taste profile
1998	Tiazzis™	Blended juiced tea in mango, citrus and wild berry flavors (caffeine free)
1999	Tazo Tea™	Via acquisition
1999	Cream & Caramel Frappiccino	
2000	Caramel Apple Cider White Chocolate Mocha Chocolate Brownie Frappuccino Orange Mocha Chip Frappuccino Gingerbread Latte	Various seasonal
2001	Crème Frappiccino™	Now with more cream
2005	Ciantico	Drinking chocolate beverage (discontinued 2006)
2005	Chai-Eggnog Latte Eggnog Frappuccino™	Various seasonal
2006	Cinnamon Dolce Latte Marble Mocha Macchiato	

## BEVERAGE ACQUISITIONS

The company has also made two strategic beverage company acquisitions (tea and water) to bring a better product range into the business than could be developed internally

### Starbucks' beverage acquisitions

(various; 1999-2005)

Date	Target	Price	Location	# of outlets	Description
1999	Tazo Tea Company	\$8.1m	United States	-	Small manufacturer of a range of specialty teas, filterbag teas and ready-to-drink teas
2005	Ethos Brands	\$8m	California	-	Privately held bottled water company based in California

## BEVERAGE OBJECTIVES

### New beverages attempt to attract new customers, expand range positioning and increase margins

- Attract new customers / health positioning
  - “As the company focuses on the trend toward healthy options, we believe it has begun its journey toward health, with a key component of this platform being the extension of the Tazo Tea brand... We believe that tea is an exciting new growth area, one that corresponds with the journey toward a healthy lifestyle and one in which Starbucks is well-positioned to extend its product portfolio and complement its existing brand. We expect future new product innovations to expand the Tazo tea brand.” *Nicole Miller, analyst, Think Equity, July 2006*
  
- Attract new customers / increase margins
  - “In general, iced beverages offer much higher margins than hot coffee. Beverages in general are more profitable than food and merchandise, rendering the continued shift favoring coffee beverages a meaningful positive from the P&L standpoint, despite the greater labor-intensity associated with hand-crafted beverages.” *Mark Kalinowski, analyst, Salomon Smith Barney, April 2000*

## B. BETTER FOOD

### Starbucks has made a number of attempts to expand and improve its food offer

#### Starbucks' attempts to expand/improve its food offer

(various; 1999-2005)

Year	Product	Details	Outcome
1999	Core food program	<ul style="list-style-type: none"> <li>- Improve the food offering with a focus on the morning day-part</li> <li>- Baked goods prepared off-site by contract caterer</li> </ul>	<ul style="list-style-type: none"> <li>- 1999: tested in 10 markets</li> <li>- 2000+: rolled out to 85%+ of stores</li> </ul>
1999	Donuts	<ul style="list-style-type: none"> <li>- Offer donuts made by Krispy Kreme</li> </ul>	<ul style="list-style-type: none"> <li>- Ongoing in 200+ stores in some markets where Krispy Kreme is located</li> </ul>
1999	Sandwich & salad lunch program	<ul style="list-style-type: none"> <li>- 10 high-quality sandwiches along with several salads</li> <li>- Trials of lunch programs in 7 major markets</li> <li>- Originally developed by Pasqua acquisition; adopted by Starbucks</li> </ul>	<ul style="list-style-type: none"> <li>- 1999: trialed in 150 stores in 7 markets</li> <li>- 2000-2001: roll-out to 700 stores</li> <li>- 2002: pull-back and revamp of quality</li> <li>- 2003+: In rollout mode; 37% of stores (05)</li> </ul>
1999	Dessert program	<ul style="list-style-type: none"> <li>- Aimed at the evening day-part; entails broadening the dessert range</li> </ul>	<ul style="list-style-type: none"> <li>- In most stores</li> </ul>
1999	Bar Chocolate	<ul style="list-style-type: none"> <li>- Range of Starbucks branded bar chocolate aimed at impulse purchase</li> </ul>	<ul style="list-style-type: none"> <li>- In most stores</li> </ul>
2005	Warm breakfast sandwich	<ul style="list-style-type: none"> <li>- Requires the baristas to heat up breakfast sandwiches (e.g., sausage and egg English muffins) in an oven</li> <li>- Enables Starbucks to compete with the more traditional hot fast-food breakfast providers, like McDonald's</li> </ul>	<ul style="list-style-type: none"> <li>- 2005: testing in 200 stores in Seattle and Wash. D.C.</li> <li>- 2006: adding 400 more stores in three new markets (Chicago, San Francisco, and Portland, Oregon)</li> </ul>

## FOOD EXECUTION DIFFICULTIES

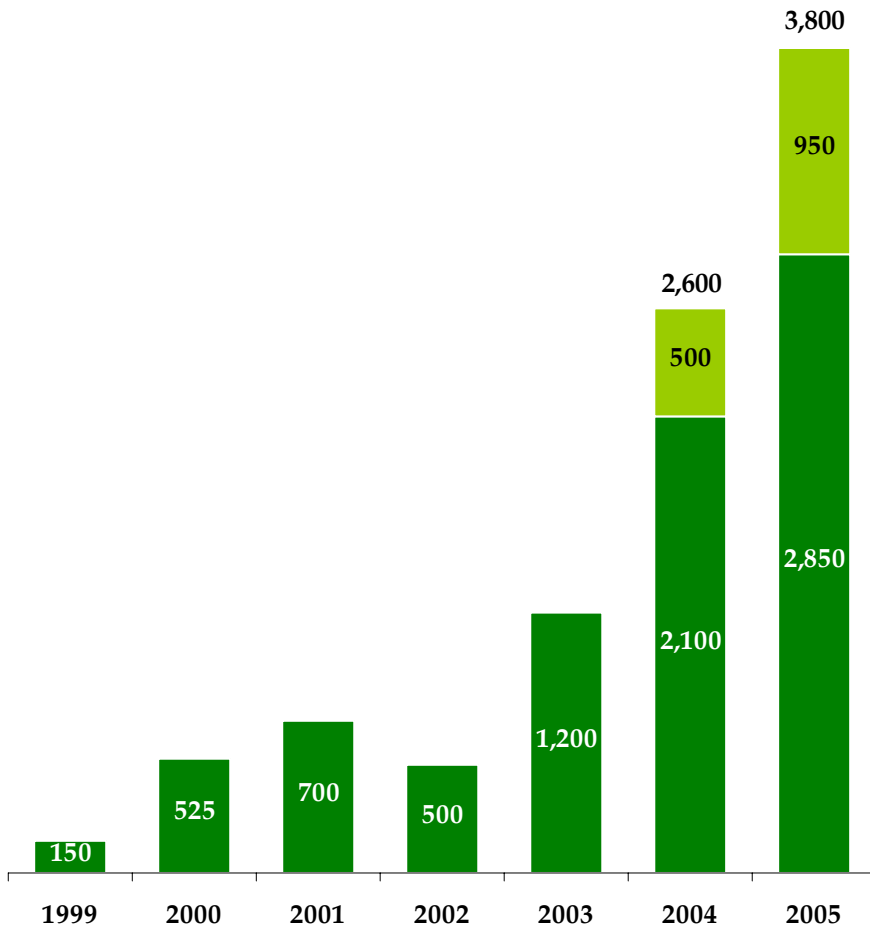
### Starbucks has had execution difficulties with food in the past

- “Several years ago, Starbucks pastries were often a day old and sandwiches were soggy. More recently, Starbucks has put a similar focus on food that it has on coffee, and it has paid off with a fresher, better, and more varied product... From 1996 to 2003, food sales grew more slowly than overall sales. Some of this was by design (Starbucks pulled sandwiches out of many of its stores in 2001-03 because the product was poor), but the other driver was that the food selection did not live up to customers’ expectations about Starbucks quality.” *Ashley Reed Woodruff, analyst, Bear Stearns, March 2006*

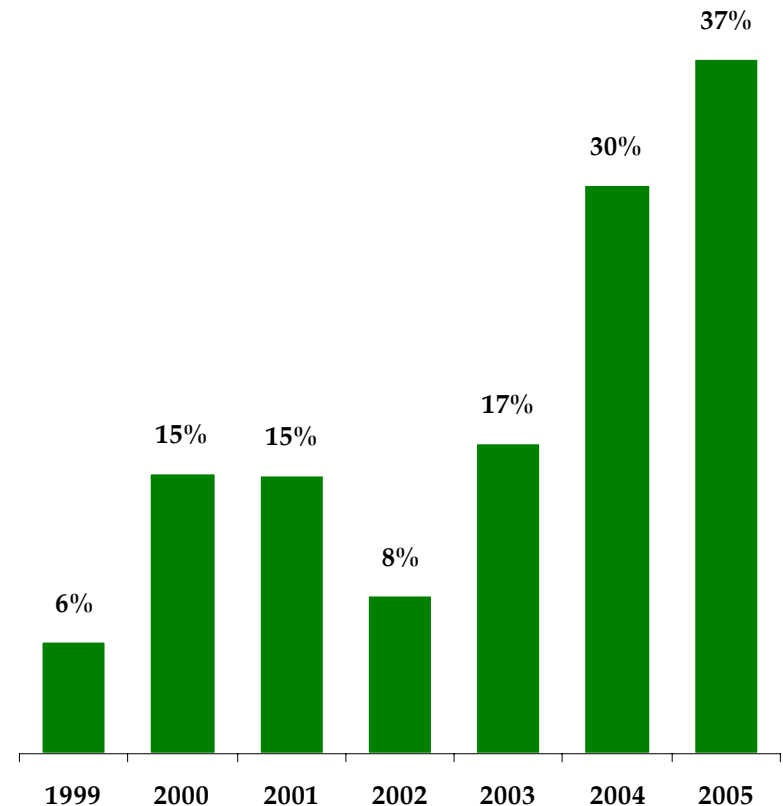
## SANDWICH & SALAD IN ROLLOUT

After a pull-back and revamp of quality in 2002, the sandwich and salad offer is now in roll-out

Number of Starbucks units with prepared sandwich & salad offer  
(actual units; 1999-2005)



% of units with prepared sandwich & salad offer  
(% of global units; 1999-2005)





## ANALYSTS POSITIVE ON FOOD OPPORTUNITY

### Analysts are generally positive on the opportunities in food

- **“Given the company’s proven ability to develop innovative beverage offerings and the potential expansion of the breakfast sandwich program currently being tested, we feel there is room to drive average unit volumes higher still.”**  
*Glen Petraglia, Citigroup analyst, May 2006*
- **“For several years, Starbucks has been rolling out a prepackaged lunch offering in its stores... Starbucks believes it can sell lunch in up to 70% of its U.S. company-operated stores eventually... Lunch adds approximately 3%, or \$30,000 annually, to sales in stores that offer the service. Over time, that percentage should improve. Although the gross margin on lunch is lower than on beverages, the operating margin should be similar, as it requires minimal additional labor costs because the sandwiches arrive at the restaurant already prepared. However, lunch does have a negative impact on margins when it is first rolled out due to higher waste, operational inefficiencies, and slightly higher staffing. Lunch enables the company to better utilize its stores during off-peak hours, as only slightly more than 10% of sales are made between 12:00 p.m. and 2:00 p.m.”**  
*Ashley Reed Woodruff, analyst, Bear Stearns, March 2006*
- **“Offering a more traditional breakfast offering seems logical, thereby reducing the need for the consumer to go to an alternative location for breakfast. This is particularly the case now that the competitors are improving the quality of their coffee offerings.”**  
*Glen Petraglia, Citigroup analyst, May 2006*
- **“Approximately 60% of U.S. locations have cold sandwich lunch offerings, and the company believes that it has the opportunity to increase that number to approximately 70% of the U.S. store base... Rollout for the lunch program has taken place over a few years as the company determines the appropriate cost structure, pricing and product mix. They also determine qualified, established suppliers to create a quality product. The new breakfast sandwich warming program is similar in that locations are rolled out on a market-by-market basis to leverage the supply chain and satisfy customer expectations. We expect the rollout of the warming program (which is currently in 580 locations) to continue over the next few years. The company believes that both programs have been incrementally positive additions thus far, adding approximately \$60,000 in revenue annually per store for each program addition (each program \$30,000). We believe that additional potential exists from the continued breakfast sandwich warming program expansion and this initiative should continue to help grow revenues.”**  
*Nicole Miller, analyst, Think Equity, July 2006*

## C. MUSIC

### Starbucks has long sold CDs of the music played in-store; it is attempting to go further into music and entertainment

- **“In addition to providing a selection of compact discs in Company-operated stores, the Company has created new and convenient ways for consumers to discover, experience and acquire all genres of music through Starbucks Hear Music™ media bars, a service that offers custom CD burning at select Starbucks retail locations in Seattle, Washington and Austin, Texas.” *Starbucks 10k 2005***
- **“Starbucks has done well selling CDs within its stores, but we estimate that CD sales only accounted for approximately 1% of U.S. retail sales in fiscal 2005. We expect Starbucks to continue to develop and market innovative CDs for sale within its stores. In fourth-quarter fiscal 2005 Starbucks added CD racks to most of its U.S. stores so it could sell a broader range of CDs than the handful it sells at the counter.” *Ashley Reed Woodruff, analyst, Bear Stearns, March 2006***
- **“In January 2006, Starbucks announced a partnership with Lions Gate Entertainment to help market and distribute a new film produced by Lions Gate, called *Akeelah and the Bee*, about an inner-city girl who goes to the national spelling bee. Starbucks will market the movie in its stores, and will sell the soundtrack and DVD when they become available (although neither will be sold exclusively at Starbucks). Starbucks did not participate in the production of the film, so its only costs will relate to in-store marketing of the film and the CD and DVD. This is a low-risk way for Starbucks to be involved in another form of entertainment, and we view its current level of involvement positively. We would view this much less positively if Starbucks were to take its involvement in movies further and begin producing movies.” *Ashley Reed Woodruff, analyst, Bear Stearns, March 2006***
- **“Multiple music and technology based initiatives designed to appeal to new and existing Starbucks customers. Among these initiatives are strategic marketing and co-branding arrangements, such as the 24-hour Starbucks Hear Music™ digital music channel 75 available to all XM Satellite Radio subscribers. Starbucks Hear Music's innovative partnerships with other music labels for the production, marketing and distribution of both exclusive and non exclusive music, music programming for Starbucks stores worldwide, and CD sales through the Company's website.” *Starbucks 10K, 2005***

## D. OTHER

Starbucks' has launched a number of other new products over the years

### Other new products (1995-2002)

Year	Product	Details
1995	Starbucks CDs	CDs of the music heard in-store
1989	Mail order catalog	Starbucks published a mail-order catalogue that was distributed six times a year and that offered coffee, candies and pastries, and select coffee-making equipment and accessories.
2000	Starbucks Barista Utopia™	"This stylish, innovative machine brews the perfect cup of coffee for customers to savor at home. Vacuum coffee brewing system
2002	Starbucks card	Stored value card for in-store purchases

## STARBUCKS CARD

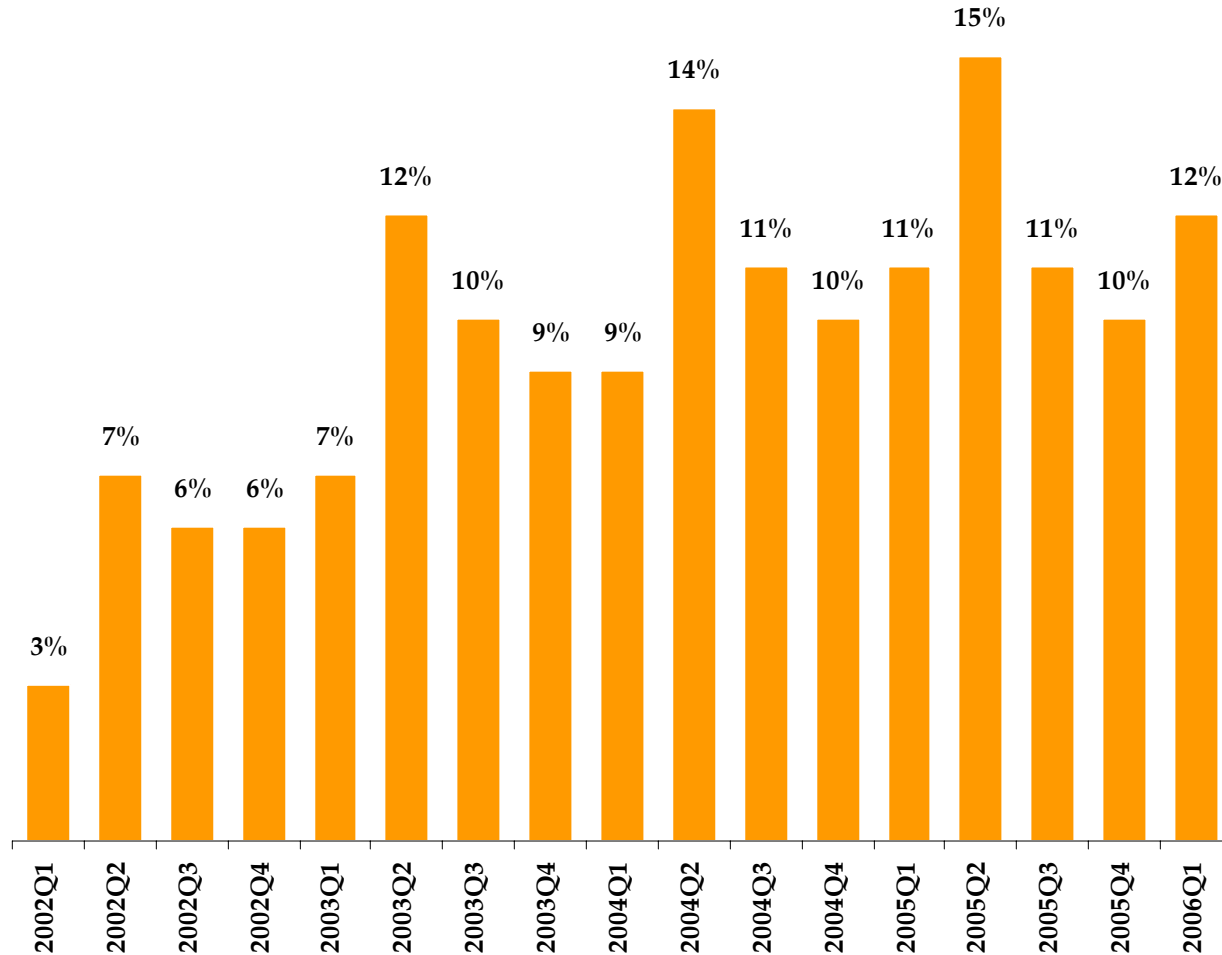
### The Starbucks Card appears to have worked

- **“The Starbucks card, which rolled out in late-calendar 2001, has been an important driver of same-store sales for the company for some time. It succeeded in both driving frequency as well as introducing Starbucks to new customers who received the card as a gift. We do not expect the Starbucks card to have the sales-driving effect it has had in the past because it has now been distributed for more than four years, but we still expect it to have a slightly positive effect on sales, particularly every January. Sales of the card have increased significantly every year since it was launched, and last quarter it accounted for 12% of North American retail (see Exhibit 6 for this trend over time). Over the past several years, Starbucks has increased its focus on selling cards in bulk to businesses like banks (such as Chase this past year) to be used as a component of customer service in the case of customer service errors or as a thank you to valued customers. In January 2006, card redemptions accounted for 22% of sales, up from 19% in the prior year. The Starbucks card creates loyalty in its users. Customers can register their Starbucks card online, so that it is replaced if stolen. For customers with registered cards, Starbucks occasionally adds extra dollars to the card as a “thank you.” Starbucks has continued to expand the card, rolling out a “Duetto” card in partnership with Visa in 2003, which is a credit card and a Starbucks card. Users receive 1% of every purchase made on their Visa card in Starbucks dollars, automatically loaded onto the Starbucks card function within the Visa Card.” Ashley Reed Woodruff, analyst, Bear Stearns, March 2006**

## STARBUCKS CARD GROWING

The Starbucks Card represents a growing percent of North American sales

Starbucks Card redemptions as a percent of North American retail sales  
 (% of retail sales; 2002/Q1-2006/Q1)



## 2. MORE STORES

Starbucks second opportunity for growth is building more stores

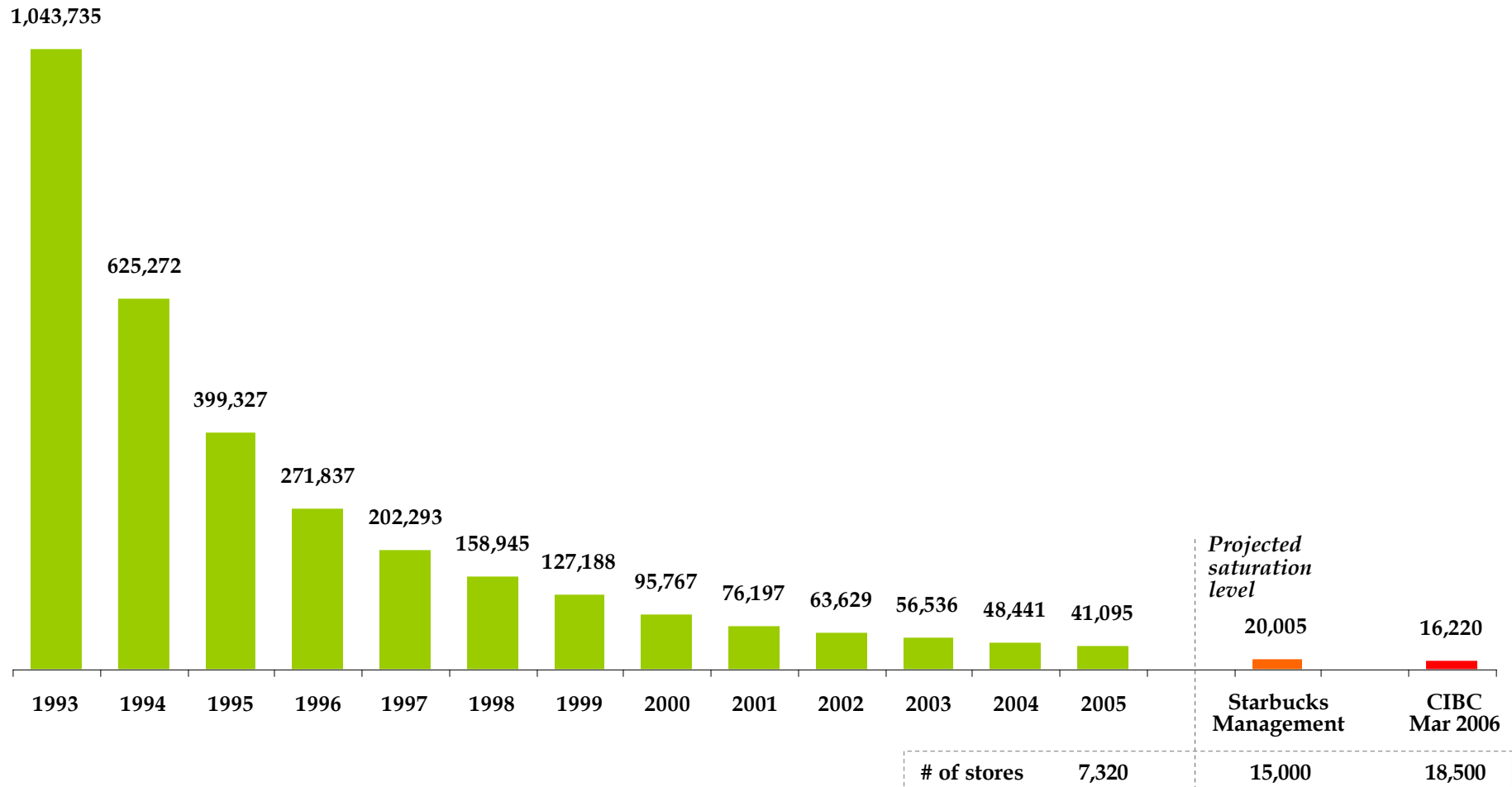
Starbucks four opportunities for growth  
(model)



## UNITED STATES INCREASING SATURATION

Starbucks is approaching market saturation in the United States but management believe it can roughly double in size again before the market is saturated

United States population per Starbucks store  
(people; actual; 1993-2005)



## CLUSTERING STRATEGY

### Clustering is an important part of the store opening strategy

- “Starbucks has a corporate strategy of clustering stores in geographic areas which provides a number of benefits, but can depress reported comps. Because of strong site selection, the earlier stores in a given market frequently reach capacity relatively quickly. While this is very positive, a store at capacity has a minimal ability to post same store sales gains, even in its early years. Thus the Company will frequently open additional stores close to the high-volume location. For example, in the DuPont circle area of D.C., the Company opened a store directly across the street from an existing store. That existing store was near capacity, and the new store quickly approached capacity as well, but the first store experienced a comp sales decline. Overall, sales, operating profit, and market share in that market increased. It is the Company’s objective to maximize market share and operating profit in every region in which it competes.
- Another factor in the store clustering strategy is customer convenience. In the D.C. example, the stores were across a 6 lane street, which is a significant obstacle to pedestrians. As the marketers of Coca Cola have known for years, one of the keys to increasing beverage sales is to provide the customer with convenience. Starbucks clustering strategy does that, and it is not uncommon to pass several Starbucks stores during a walk, and see all of them full.
- Finally, before opening incremental stores, Starbucks carefully analyzes the returns to such stores and will only open them if the returns justify it. Incremental stores benefit from scale economies in supply logistics, and regional management. These incremental stores are frequently very attractive investments in their own rights. But an additional benefit of opening incremental stores is that it raises barriers to entry from potential competitors. By occupying good sites, Starbucks makes it much more difficult for a competitor to establish a strong market presence. Overall, we believe these factors which can depress comps are sufficiently positive for the business that we would not put such an intense focus on comps – particularly any given month’s comps – at this stage of the Company’s development. Given the overall strength of Starbucks’ retail execution, we would use weak monthly comp numbers as opportunities to add to positions. Longer term, we believe that the regional clustering strategy will enhance Starbucks’ overall market position despite the impact on comps.” *Kim Galle, analyst, Adams, Harkness & Hill, August 1996*



## CANNIBALIZATION IS REAL

### However, the company admits cannibalization is real

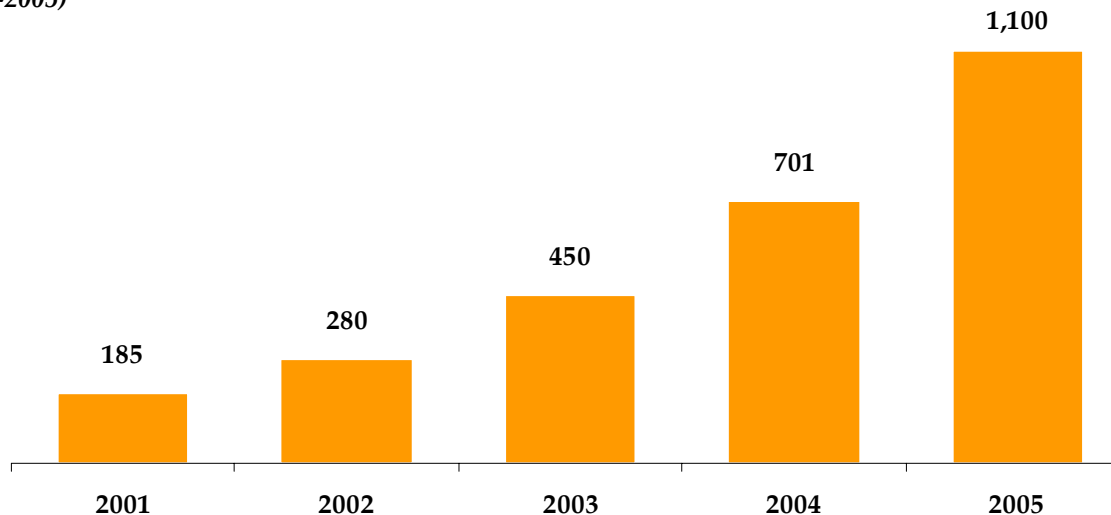
- **“Starbucks is remarkably candid in stating that if demand at a single retail location warrants another location in extreme proximity (to cut down on wait times, for example), then it will not hesitate to open another venue. For example, in the past it has not been unheard of for Starbucks to erect new locations placed as little as 50 yards away from existing locations. Two stores facing each other on Robson Street in Vancouver each generate more than \$1 million in annual sales. Starbucks management states that the same-store sales growth metric is not necessarily the best method by which to evaluate the company’s retail performance, as such gains will take a hit from the “clustering” tactic. Investors should be aware that to the extent that this practice occurs, same-store sales for the overall retail positioning on the company could come under pressure. Nevertheless, we do not view clustering as an exceedingly worrisome risk, as same-store sales growth to date has been remarkable even in the face of such tactical moves in the past. About 30% of stores went up against clustering in fiscal 1999; we do not expect this percentage to rise in 2000. Cannibalized stores typically experience a 10%-15% initial decline in their business, but tend to revert to prior levels of activity within two to three years.”** *Mark Kalinowski, analyst, Salomon Smith Barney, April 2000*

## ROLLING OUT DRIVE THRU

### Starbucks is rapidly rolling-out drive-thru units

- “In our view, the advent and success of the drive-thru units has been one of the most important elements of Starbucks’ increased new unit productivity and one of the highest return investments the company currently has... Drive-thrus have made up nearly one-third of new openings in each of the last two years and show no sign of slowing in the future. We believe this often overlooked aspect of the Starbucks story supports our increased estimate for the concept’s long-term unit potential. The importance of the drive-thru window at a traditional fast food restaurant cannot be understated, generating roughly 50%-60% of a unit’s revenue. Although we don’t necessarily believe that Starbucks will – or even strives – to achieve this kind of drive-thru mix, it is clear that this type of format can open up new growth opportunities for the company. The unit economics are compelling, with the average drive-thru producing first year revenue of approximately \$895,000, or 35% more than the first year volume of a standard unit’s \$665,000, and yet cost Starbucks only 12% more, yielding a 57% first year cash-on-cash return vs. a 47% return for a standard unit.” *John Glass, analyst, CIBC, June 2004*

Number of Starbucks drive-thru locations  
(units; actual; 2001-2005)



**INTERNATIONAL GROWTH OF GROWING IMPORTANCE**

**Recently Starbucks' management projected a potential for 30,000 stores globally - up from 10,241 in FY2005 - with much of this growth coming from international markets**

Starbucks store numbers: current and management projections  
*(stores; 2005 v projected)*

	Current (FY 2005)	Announced Target	Growth Potential
United States	7,302	15,000	+7,698
Canada	552	1,000	+448
Latin America	140	1,500	+1,360
Asia-Pacific	1,438	6,500	+5,062
Europe/Middle-East/Africa	809	6,000	+5,191
	10,241	30,000	+19,759

} **International  
+12,061**

## 37+ COUNTRIES

Starbucks currently has operations in 37+ countries

Starbucks current countries of operation  
(stores; 2005)



## INTERNATIONAL OPERATIONS

Starbucks generally enters markets through a licensed joint-venture with a partner...

## Starbucks international store operations

(various; 1987-2000)

Year	Country	Licensee or JV Partner	# of stores (FY2005)	Starbucks Ownership	Comment
Mar 1987	Canada	-	552	100%	Organic entry in 1987
Aug 1996	Japan	Sazaby Inc.	572	40%	50/50 JV; listed in Japan; later sold down share
Dec 1996	Singapore	Bonvests Holdings Ltd.	32	100%	Acquired licensee (had 0%)
1997	Hawaii	The MacNaughton Group	51	100%	Acquired licensee (had 5%)
Dec 1997	Philippines	Rustan Coffee Corp.	83	-	No Starbucks ownership
Mar 1998	Taiwan	President Group	153	50%	Increased shareholding from 5%
Jul 1998	Thailand	Coffee Partners Co.	63	100%	Acquired licensee (had 0%)
Oct 1998	New Zealand	Restaurant Brands	41	-	No Starbucks ownership
1998	United Kingdom	-	478	100%	Purchased Seattle Coffee Company
1998	South Africa	?	-	-	2 store SBC Franchise via acquisition; divested
Jan 1999	Beijing, China	Beijing Mei Da Coffee Co.	?	51%	Increased shareholding from 5%
Dec 1998	Malaysia	Berjaya Group Berhad	62	49.9%	Increased shareholding from 5%
Jul 1999	South Korea	ESCO	133	50%	Increased shareholding from 0%
Feb 1999	Kuwait	MH Alshaya Co.	32	-	No Starbucks ownership
Nov 1999	Lebanon	MH Alshaya Co.	10	-	No Starbucks ownership
Apr 2000	UAE/Dubai	MH Alshaya Co.	37	-	No Starbucks ownership
July 2000	Australia	Starbucks Coffee Australia	58	100%	Increased shareholding from 90%
Aug 2000	Qatar	MH Alshaya Co.	8	-	No Starbucks ownership
2000	Hong Kong	Maxim's (Dairy Farm Asia)	60	5%	

## INTERNATIONAL OPERATIONS

... continued

## Starbucks international store operations

(various; 2001-2005)

Year	Country	Licensee or JV Partner	# of stores (FY2005)	Starbucks Ownership	Comment
2001	Bahrain	MH Alshaya Co.	8	-	No Starbucks ownership
2001	Saudi Arabia	MH Alshaya Co.	38	-	No Starbucks ownership
2001	Israel	Delek Group	-	-	Licensee financing issues; poor performance
2001	Switzerland	Bon Appetit Group AG	21	50%	Transferred to Marinopoulos (Greek licensee)
2002	Austria	Bon Appetit Group AG	9	50%	Transferred to Marinopoulos (Greek licensee)
2002	Germany	KarstadtQuelle AG	44	100%	Acquired licensee (had 50%)
2002	Spain	Sigla SA	39	50%	-
2002	Greece	Marinopoulos Holdings	38	18%	-
2002	S. China/Macau	Maxim's (Dairy Farm Asia)	20	51%	Increased shareholding from 5%
2002	Indonesia	PT Mitra Adiperkasa	32	-	No Starbucks ownership
2002	Oman	MH Alshaya Co.	4	-	No Starbucks ownership
2002	Mexico	Alsea SA de CV	60	~20%	-
2002	Puerto Rico	The MacNaughton Group	11	100%	Acquired licensee (had 20%)
2003	Turkey	MH Alshaya Co.	24	-	No Starbucks ownership
2003	Peru	Delosi SA	6	-	No Starbucks ownership
2003	Chile	Grain Red SA	10	100%	Acquired poorly performing licensee (had 20%)
2004	France	Sigla SA	16	50%	-
2004	Cyprus	Marinopoulos Holdings	7	18%	w/Greek licensee
2005	Ireland	-	1	100%	Organic entry in 2005
2005	Jordan	MH Alshaya Co.	4	-	No Starbucks ownership
2005	The Bahamas	?	2	?	-

## CHARACTERISTICS OF AN INTERNATIONAL PARTNER

### Starbucks looks for the following characteristics in an international partner

Starbucks desired characteristics in a international partner  
(2006)

- “Our global success would not be possible without our international partners, who share in our values and commitment to bringing the Starbucks Experience to customers worldwide. How we choose partners is critical to our success:
  - Shared values and corporate culture
  - Strategic fit
  - Seasoned operator of small-box, multi-unit retail
  - Sufficient Financial and Human Resources
  - Involved and committed top management
  - Real Estate Knowledge and Access
  - Local Business Leader
  - Strong track record developing new ventures
  - Experience Managing Licensed & Premium Brands and Concepts
  - Leverageable Infrastructure
  - Food & Beverage Experience

## INTERNATIONAL ACQUISITIONS

Strategic acquisitions have been an important growth vehicle for Starbucks in the UK – all other acquisitions have been taking a further share in existing licensees

### Starbucks international acquisitions

(various; 1998-2006)

Date	Target	Price	Location	# of outlets (at time)	Description
1998	Seattle Coffee Company	\$88.6m	United Kingdom	56	All converted
2000	Coffee Partners Co.		Thailand	38	Acquired licensee (had 0%)
2000	S. Korea licensee	n/a	South Korea	6	Bought 50% of licensee
2002	Australian licensee/JV	n/a	Australia	30	Acquired remaining 10% share in Australian JV
2002	13 Coffee Republic stores	\$3.1m	United Kingdom	13	13 stores from Coffee Republic
2003	Bon Appetit Group AG	n/a	Switzerland & Austria	?	Owned 50% of original JV; acquired 100% in 2003; then sold 50% to Marinopoulos (Greek licensee)
2003	Taiwan licensee/JV	n/a	Taiwan	?	Increased equity ownership from 5% to 50%
2003	Spanish licensee/JV	n/a	Spain	?	Increased equity ownership from 20% to 50%
2003	Shanghai licensee/JV	n/a	Shanghai	-	Increased equity ownership from 5% to 50%
2004	Singapore licensee	n/a	Singapore	35	Acquired licensee (had 0%)
2004	Malaysian licensee	n/a	Malaysia	52	Increased equity ownership from 5% to 50%
2005	German licensee	n/a	Germany	44	Acquired licensee (had 18%)
2005	Southern China licensee	n/a	S. China	?	Increased equity ownership from 5% to 51%
2005	Chile licensee	n/a	Chile	10	Acquired licensee (had 15%)
2006	Hawaii licensee	n/a	Hawaii	54	Acquired licensee (had 5%)
2006	Puerto Rico licensee	n/a	Puerto Rico	13	Acquired licensee (had 5%)



## BUYING OUT LICENSEES

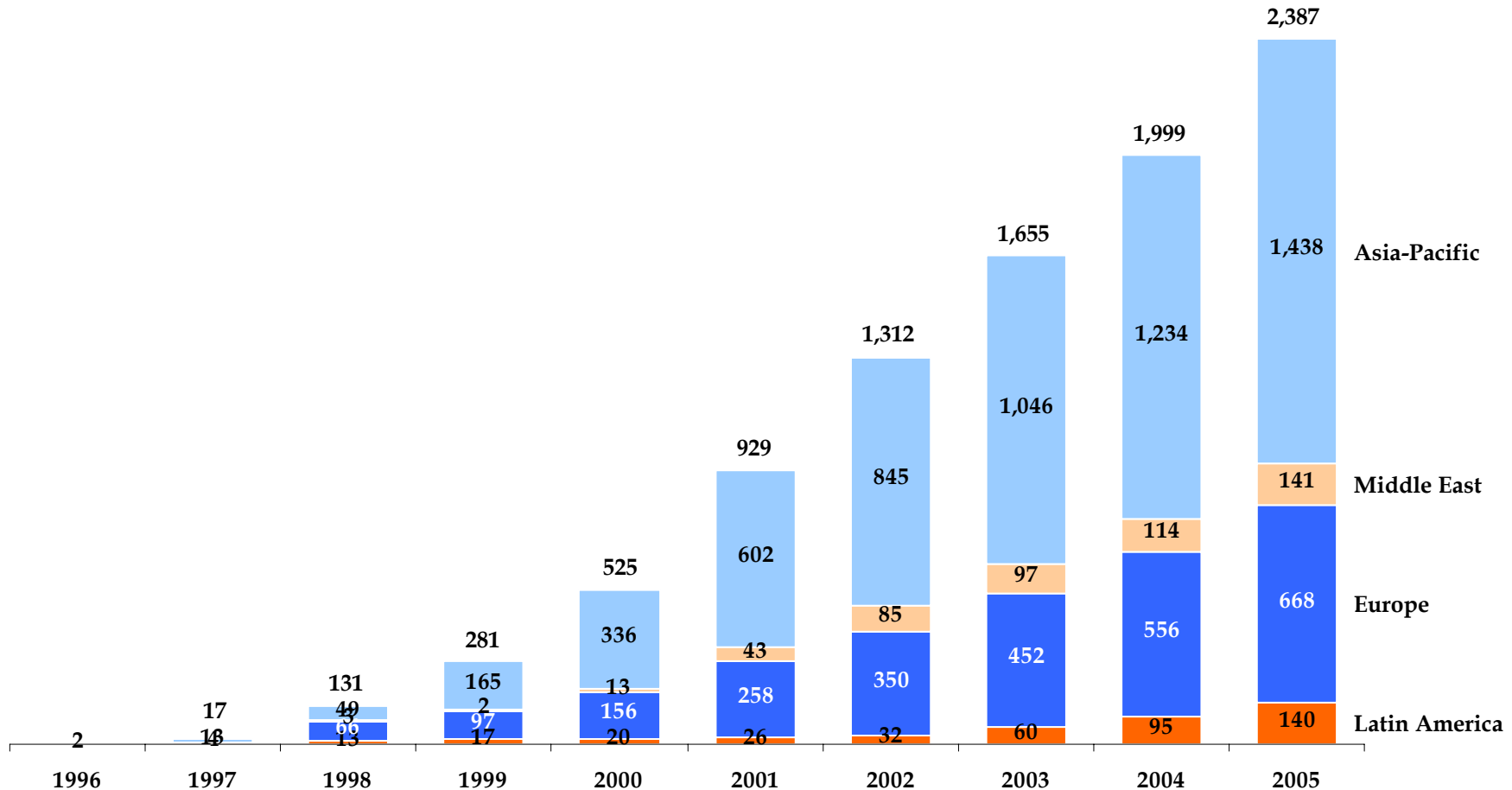
### Buying out licensees in international Starbucks operations makes financial sense

- **“Increasing ownership of international retail stores. Starbucks has grown its international business rapidly and in a capital-efficient manner through its licensing strategy. As the company matures, it will be able to increase its equity ownership, offering a further growth opportunity.”** *Howard Penney, analyst, Friedman, Billings Ramsey & Co., Feb 2005*
- **“Starbucks has the right to buy up to 50% of its international joint ventures at year five and year ten of its agreements, using a pre-agreed upon valuation formula. As the buy-in multiple is lower than the current level SBUX shares trade at (22.6x trailing EBITDA and 18.4x forward EBITDA) these are accretive acquisitions for Starbucks. We think one of the reasons Starbucks’ multiple is so high is partially to reflect the potential value of these joint ventures, which Starbucks can buy into. Many of these markets are still in their early stages of growth and not yet profitable, but have the potential to be significantly profitable over time. There are currently approximately 20 markets in which Starbucks owns a less than 20% stake.”** *Ashley Reed Woodruff, analyst, Bear Stearns, March 2006*
- **“Internationally, Starbucks is taking a rational approach to its aggressive expansion, seeking partners to develop the business in a region while the company gradually increases its equity ownership stake.”** *Glen Petraglia, Citigroup analyst, May 2006*

## ASIA-PACIFIC & EUROPE

The Asia-Pacific region and Europe have accounted for much of the international unit growth to date

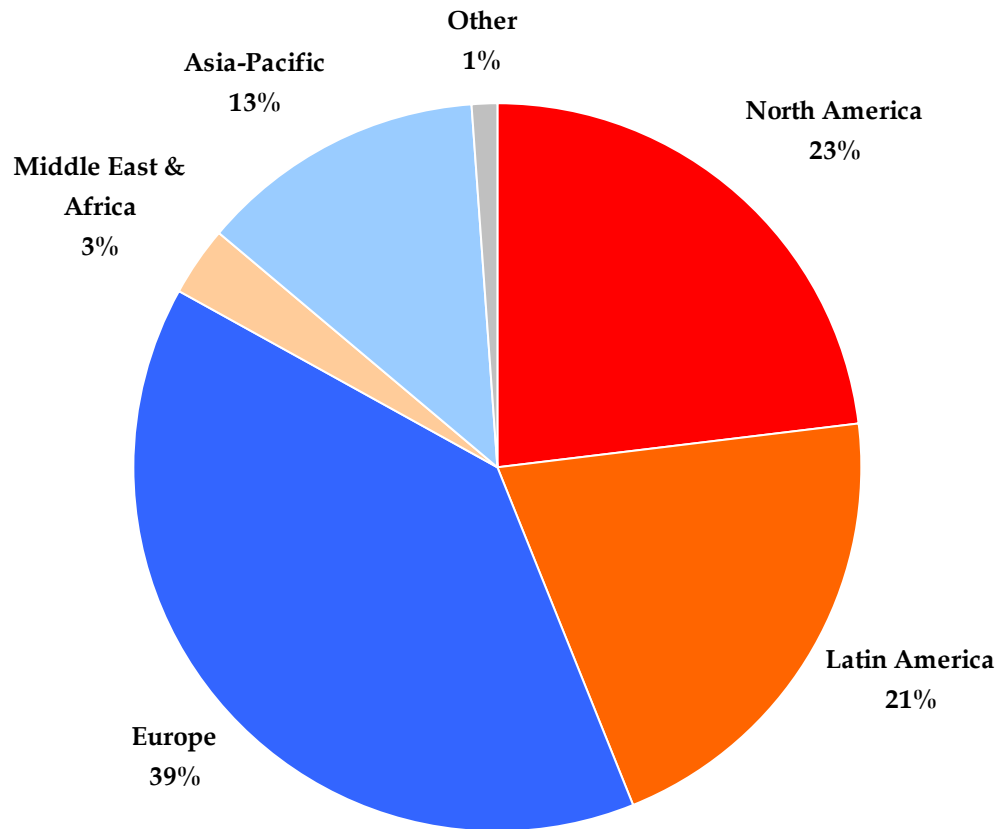
Starbucks store number by region (x North America)  
(stores; actual; 1996-2005)



## EUROPE & LATIN AMERICA

Further expansion in Europe and Latin America stand out as strong opportunities from a raw coffee consumption point-of-view

Coffee consumption (all forms) by geographic region  
(% of volume; 2002)



## EUROPE A CHALLENGE THOUGH

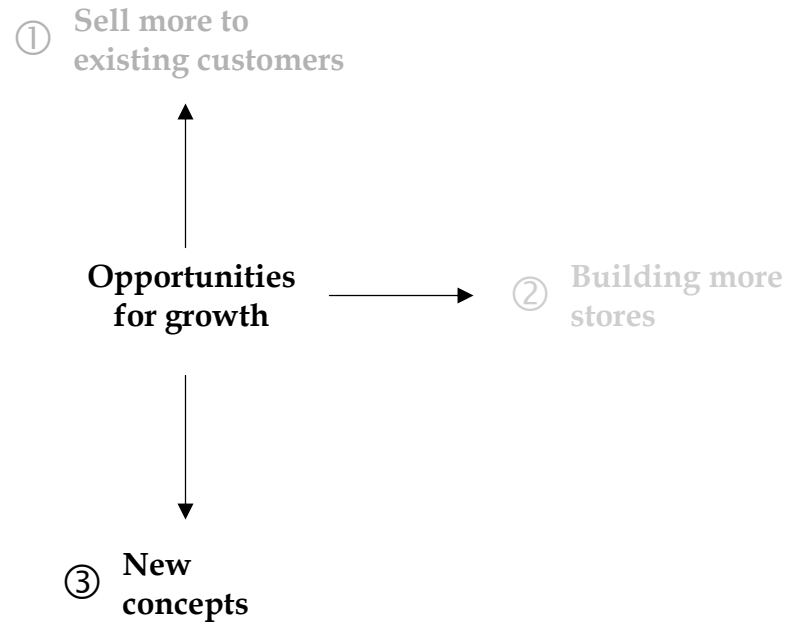
However, there is a belief that Europeans will not warm to the Starbucks model as well as others

- “Outside of the United Kingdom, Europe likely will prove to be a more challenging market for Starbucks than either North America or Asia. There is less of an affinity for American brands in Europe than elsewhere, although this generalization may be less true of younger generations. Also, Europe has a long high-quality coffeehouse tradition, particularly in France and Italy... However, we do look for the company to enter... essentially every European country of note eventually. In the near term, the opportunities appear fairly large; we believe the company has identified its eight initial markets on the Continent. (Scandinavia could be one area of initial focus, particularly given the colder climate.)... Bear in mind that smoking is more prevalent in Europe than in the United States. Since Starbucks prides itself on the quality of its coffee, including the aroma, we find it difficult to believe the company would let its beverages be contaminated by second-hand smoke. A smoke-free atmosphere may drive away some European consumers... A tidbit of note – according to the Puget Sound Business Journal, founder Schultz has already selected the exact street corner on which Starbucks will open its first Italian outlet; this site is called the “birthplace of the Starbucks concept.” *Mark Kalinowski, analyst, Salomon Smith Barney, April 2000*
- “After overcoming some hurdles in the U.K., Starbucks has successfully penetrated younger consumers in the urban centers. The balance of Europe has a long history of coffee consumption. Many independent coffee houses and cafés provide a relaxed atmosphere in which to sip high-grade coffee and espresso and possibly smoke a cigarette. This history with European’s skepticism of America’s biggest brands previously caused concern about Starbucks’ acceptance in European markets. However, these worries appear to have been dispelled by Starbucks stores’ success in Paris, France. The seven stores in Paris have performed well since their opening in FY04. While these stores have drawn American tourists and Europeans that appreciate a non-smoking environment, they have also drawn a wide audience of ordinary Parisians. We expect Starbucks elsewhere in Europe to meet with similar acceptance and success.” *Howard Penney, analyst, Friedman, Billings Ramsey & Co., Feb 2005*
- “Premium coffee has always been popular in Europe. In several international markets, but particularly Europe, Starbucks did not “invent” the specialty coffee café market as it did in the United States. Although specialty coffee did exist in the U.S. before Starbucks, it was not as widely consumed as it has been in Europe for years. This is why we think Asia, and particularly China, represents a greater opportunity for Starbucks long term, because it has been able to introduce the often tea-drinking nations to coffee... We think Europe will likely be the company’s toughest market for several reasons... There are many cafés across Europe, particularly in France and Italy, that already act as the “third place” (i.e., between home and work) that Starbucks wants to be (in fact, it is in Italy where Howard Schultz got the idea to create what became the Starbucks café).” *Ashley Reed Woodruff, analyst, Bear Stearns, March 2006*

### 3. NEW CONCEPTS

## Starbucks third opportunity for growth is new store concepts

Starbucks four opportunities for growth  
(model)



## ONE CONCEPT ACQUISITION/LATER DIVESTED

Starbucks has only made one acquisition of another food concept – a shareholding in Noah's Bagels which was later sold – as well as Hear Music and a failed rush into dot.com madness

## Starbucks' restaurant &amp; internet concept acquisitions

(various; 1995-2001)

	Target	Price	Location	# of outlets	Description
1995	24% of Noah's New York Bagels Inc	\$11.3m	California	?	25% share in fast growing regional (later national) bagel retailer; had right to purchase 100% share in 2000; instead sold in 1996
1999	Hear Music	\$10m	US/Canada	4	Website plus 4 retail locations + 12 licensed locations in Chapters Bookstores in Canada
1999	Living.com	\$20.3m	United States	-	7% of online furniture retailer
1999	Cooking.com	\$10.0m	United States	-	Web-based retailer of cookware
2000	Kozmo.com	\$25.0m	United States	-	5% of internet-to-door delivery service for food/convenience items
2001	Talk City Inc.	n/a	United States	-	Internet chat site provider

### THREE NEW STORE FORMATS

Starbucks has developed and tested three new store concepts, none of which have gone beyond testing (at this point)

Starbucks' store formats  
(1998-2004)

	Category	Units	Partner
1998	Café Starbucks	3+ tested in Seattle	<p>"European-style café concept with simple yet delicious menu" including wait staff, entrees and alcohol</p> <p>Food offering ranges from meat-loaf to chicken pot pie (European?)</p> <p>tested in three greater Seattle locations</p>
1998	"Circadian Coffee"	1+ tested in San Francisco	<p>"Targeted towards younger customers who were not necessarily core Starbucks consumers - targeting instead the "Greenwich Village" crowd and projected to have a higher alcohol component than the Café Starbucks concept</p> <p>"Upscale, hip alternative to a traditional bar"; live performance during the weekend</p>
2004	Starbucks Hear Music™ Coffeehouse	3	<p>a first-of-its-kind music store in Santa Monica, California. The Company has also opened two additional Hear Music Coffeehouses in Miami, Florida and San Antonio, Texas in fiscal 2006.</p>

## CAFÉ TO RESTAURANT

**Two concepts - Café Starbucks and Circadia Coffee - have attempted to move from a beverage-focused café into a more traditional restaurant offer**

- **“Starbucks runs two concepts that are more similar to traditional restaurants: Café Starbucks and Circadia Coffee House. At present, there are three and two of each, respectively. (Cafe Starbucks can be found only in Washington state, while the Circadia restaurants are in California.) Both concepts shy away from dinner offerings. Cafe Starbucks concentrates on breakfast, lunch, desserts, and beverages; the menu features coffee-based alcoholic beverages, bottled beers, wine, ice cream, a variety of cakes (e.g., mocha Frappuccino cheesecake), breakfast foods, individual-size pizzas, grilled sandwiches, salads, and specialty sandwiches. Circadia is a more bar-like concept, and fosters an atmosphere of online connectivity and dot com professionalism. Business people can connect to the Internet during the day; one location even features a room that can be rented out for business meetings.**
- **The company continues to tinker with both concepts. Ultimately, we believe there may be room for 25-40 Cafe Starbucks throughout the United States. However, we think the company should stay focused on its regular coffeehouses – the greater the focus on the proper operation and expansion of the core Starbucks concept, the better, in our opinion. For now, though, Cafe Starbucks and Circadia serve as R&D labs of sorts, allowing the company to test new ideas and initiatives. This can have a beneficial spillover into the Starbucks stores – for example, some of the food items developed at Cafe Starbucks have already found their way into Starbucks coffeehouses.”** *Mark Kalinowski, analyst, Salomon Smith Barney, April 2000*



## THE FORMATS

Circadia Coffee was an attempt to move into the evening day-part, with more bar characteristics such as alcohol while Hear Music has a music focus



*Circadia Coffee, 2001*



*Circadia Coffee, 2001*



*Starbucks Hear Music™ Coffeeshop*

## HEAR MUSIC AS A PLATFORM

### Starbucks acquired Hear Music as a platform on which to further develop its in-store music offer

- “In October 1999, Starbucks paid less than \$10 million for San Francisco-based Hear Music. By the end of fiscal 2000, Hear Music will be the exclusive music brand on offer at Starbucks’ retail locations. Although music represents less than 1% of Starbucks sales at present, it is one of the fastest-growing merchandise categories... Management views music as a natural extension of the Starbucks experience. We tend to agree, looking at the past popularity of promotions of jazz recordings as a guide (Starbucks first sold CDs in 1995). The advent of listening stations and other new technologies could provide a modest boost to sales. The company operates a website, which can be reached directly from the Starbucks website. Hear Music also has four retail locations in California, one in Chicago, and 12 licensed locations found within Chapters bookstores in Canada. Starbucks had already worked with Chapters (for in-store cafes) beginning in 1995. At present, Starbucks management does not rule out the possibility of further retail Hear Music locations, although we would prefer company focus to remain riveted to Starbucks outlets.” *Mark Kalinowski, analyst, Salomon Smith Barney, April 2000*
- “HearMusic, a company purchased by Starbucks in 1999, allows customers to create personalized CDs from a library of songs, maintained in each retail store equipped with the Hear Music gear. We view Hear Music as a brand-building investment, rather than a meaningful part of Starbucks’ growth story.” *Howard Penney, analyst, Friedman, Billings Ramsey & Co., Feb 2005*
- “The company has been testing further expansion of Hear Music, called Hear Music Media Bar, in which customers can burn their own customized CD within a traditional Starbucks store, choosing from over 200,000 tracks. The service has been tested in 40 stores in Seattle and Austin for more than a year, but the company has not rolled-out the product further since the initial introduction in these stores. We estimate that the investment cost per store is approximately \$20,000, so Starbucks would need to generate approximately \$40,000 in sales to justify the expense – it targets at least a 2:1 sales-to-investment ratio. If we assume the average CD costs \$10 (\$7.99 for the first seven songs and \$0.99 per song thereafter), this implies that the company needs to sell approximately 11 CDs per store per day to meet its return requirements. We think the average in test stores is five or slightly more currently. We do not believe Starbucks is committed to the Hear Music Media Bar program yet, because we do not believe it has been as successful as hoped for, the capital investment and space requirement is a factor, as well as a consumer shift to other forms of music distribution like MP3 downloads. The company has hinted it may use its nationwide wi-fi hotspot capability in its music initiative, but to our knowledge has not yet tested this.” *Ashley Reed Woodruff, analyst, Bear Stearns, March 2006*

## HEAR MUSIC OUTLETS

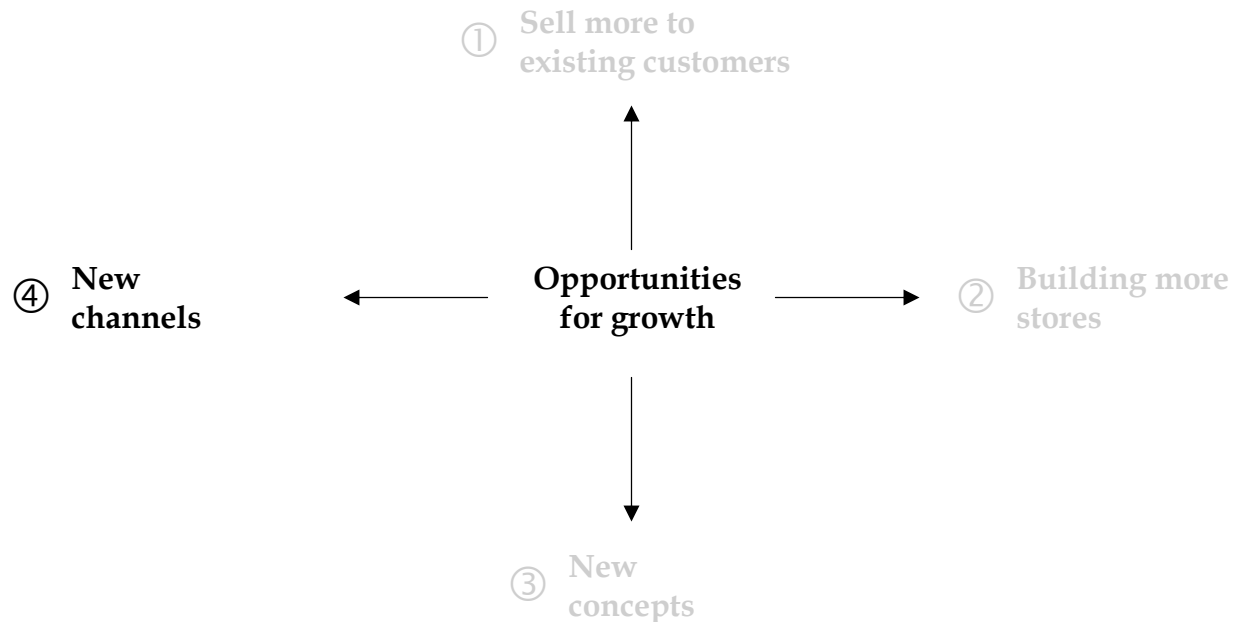
### Starbucks has also opened three Starbucks Hear Music stores

- **“Starbucks Hear Music announced that its third Starbucks Hear Music™ Coffeehouse... will open to the public today. This innovative retail store blends the classic Starbucks coffeehouse experience with an extensive selection of physical CDs and the next generation of the Hear Music™ media bars which provide customers with an easy, fun, self-service way to discover and customize music on CDs drawing from more than 1 million digital tracks – offering a fully integrated coffee and music experience. The opening of the Starbucks Hear Music™ Coffeehouse in Miami follows the launch of the Starbucks Hear Music™ Coffeehouse in San Antonio, which opened in December 2005, and the flagship location in Santa Monica, Calif., which opened in March 2004.” *Starbucks press release, Feb 2006***
- **“In addition to providing a selection of compact discs in Company-operated stores, the Company has created new and convenient ways for consumers to discover, experience and acquire all genres of music through Starbucks Hear Music™ media bars, a service that offers custom CD burning at select Starbucks retail locations in Seattle, Washington and Austin, Texas, and the Starbucks Hear Music™ Coffeehouse, a first-of-its-kind music store in Santa Monica, California. The Company has plans to open two additional Hear Music Coffeehouses in Miami, Florida and San Antonio, Texas in fiscal 2006.” *Starbucks 10k 2005***
- **“Recently, Starbucks has significantly increased its commitment to its entertainment initiative, by adding CD racks to its stores, announcing a partnership with Lions Gate Entertainment, and expanding its Hear Music Coffee House initiative. Music has long been a part of the Starbucks coffee house experience and coffee houses in general, as it complements the experience... Thus far, in Starbucks CD business and its most recent foray into movies and DVDs, the amount of capital invested has been minimal and the company has maintained a strong focus on return on capital. The Hear Music Media Bars in Seattle and Austin, which did require more capital, have not been expanded farther, because, we believe, the company did not meet its return-on-capital hurdle. As long as it continues to be approached cautiously, we view the entertainment initiative as a cautious positive.” *Ashley Reed Woodruff, analyst, Bear Stearns, March 2006***

## 4. NEW CHANNELS

### Starbucks fourth opportunity for growth is developing new channels

Starbucks four opportunities for growth  
(model)



## BRAND EXTENSIONS

Starbucks has extended its brands into a number of retail food and beverage categories, primarily through joint-ventures or licensing

Starbucks' retail line extensions  
(various)

Category	Product	Partner	
Beer	Redhook Ale Double Black Stout™	Redhook Brewery	Stout beer containing coffee extract
Beverage	Mazagran™	Pepsi-Co JV	Unique sparkling coffee-based beverage
	Frappuccino®	Pepsi-Co JV	Icy, creamy low fat beverage
	Starbucks Double Shot™	Pepsi-Co JV	RTD Coffee drink
RTD Iced Coffee	Starbucks' Discoveries™	Suntory (Japan) Uni-President (Taiwan) Dong Suh (South Korea)	RTD chilled cup coffee beverage in refrigerated cases of convenience stores
Ice Cream	Starbucks Coffee-flavored Ice Cream	Nestle/Dreyer's JV	Various coffee flavored super-premium ice-creams
Roast Coffee	Retail coffee	Trials on their own Then via licensing of brand to Kraft	Retail whole bean and ground coffee
Snacks	Starbucks Coffee Bars	?	Nutritional snack bars with a coffee flavor
Alcohol	Starbucks Coffee Liqueur	Jim Beam Brands Co.	Coffee flavored liqueur range

## FOODSERVICE

### Starbucks sells foodservice coffee through major distributors

- **“The growth of Starbucks’ foodservice sales has consistently kept pace with retail sales over the last four years. In FY03, Starbucks transitioned most foodservice accounts to SYSCO’s distribution network, increasing customer service and support resources and the number of customer accounts. Accounts have grown from 5,600 in FY02, to 12,800 in FY03, to 13,700 in FY04. SYSCO services more than 400,000 foodservice accounts, including about 256,000 restaurants, 20,000 schools, 24,000 hotels, 40,000 healthcare institutions, and 60,000 other accounts. The 13,700 accounts Starbucks has today at SYSCO represent less than 10% of SYSCO’s non-restaurant foodservice accounts. Most recently, Starbucks’ foodservice sales grew from 27% of total revenue in FY03 to 31% in FY04, a 54% increase. We expect foodservice revenue to continue to keep pace with retail revenue as the number of accounts increases, the variety of products sold into the accounts increases, and the products gain more traction in the marketplace. “Howard Penney, analyst, Friedman, Billings Ramsey & Co., Feb 2005**