STARBUCKS CORP
Form 10-Q
August 02, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549
FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Quarterly Period Ended July 1, 2012
OR
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to .
Commission File Number: 0-20322
STARBUCKS CORPORATION
(Exact Name of Registrant as Specified in its Charter)

Washington	91-1325671
(State or Other Jurisdiction of Incorporation or Organization)	(IRS Employer Identification No.)

2401 Utah Avenue South, Seattle, Washington 98134
(Address of principal executive offices)
(206) 447-1575
(Registrant's Telephone Number, including Area Code)
Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer x	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act): Yes ¨ No x
Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Title	Shares Outstanding as of July 25, 2012
Common Stock, par value $0.001 per share	760.0 million

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PART I — FINANCIAL INFORMATION
Item 1. Financial Statements
STARBUCKS CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS
(in millions, except per share data)
(unaudited)

	Quarter Ended		Three Quarters Ended	
	Jul 1, 2012	Jul 3, 2011	Jul 1, 2012	Jul 3, 2011
Net revenues:				
Company-operated stores	$2,615.6	$2,417.3	$7,868.6	$7,162.1
Licensed stores	308.2	248.7	905.1	740.8
CPG, foodservice and other	379.8	266.2	1,161.7	765.8
Total net revenues	3,303.6	2,932.2	9,935.4	8,668.7
Cost of sales including occupancy costs	1,446.1	1,237.5	4,354.1	3,601.0
Store operating expenses	976.0	917.1	2,928.3	2,672.2
Other operating expenses	105.9	100.0	317.9	289.0
Depreciation and amortization expenses	136.7	129.5	408.6	386.1
General and administrative expenses	199.0	190.2	597.4	557.0
Total operating expenses	2,863.7	2,574.3	8,606.3	7,505.3
Income from equity investees	51.7	44.3	148.8	116.9
Operating income	491.6	402.2	1,477.9	1,280.3
Interest income and other, net	9.7	16.0	68.2	50.3
Interest expense	(8.9)	(8.5)	(26.2)	(23.5)
Earnings before income taxes	492.4	409.7	1,519.9	1,307.1
Income taxes	159.1	129.9	494.2	417.2
Net earnings including noncontrolling interests	333.3	279.8	1,025.7	889.9
Net earnings attributable to noncontrolling interests	0.2	0.7	0.6	2.5
Net earnings attributable to Starbucks	$333.1	$279.1	$1,025.1	$887.4
Earnings per share - basic	$0.44	$0.37	$1.36	$1.19
Earnings per share - diluted	$0.43	$0.36	$1.33	$1.15
Weighted average shares outstanding:				
Basic	758.9	750.5	753.8	748.8
Diluted	776.8	771.9	772.9	770.1
Cash dividends declared per share	$0.17	$0.13	$0.51	$0.39

See Notes to Condensed Consolidated Financial Statements

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STARBUCKS CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(in millions, except per share data)
(unaudited)

	Jul 1, 2012	Oct 2, 2011
ASSETS		
Current assets:		
Cash and cash equivalents	$1,501.3	$1,148.1
Short-term investments	996.3	902.6
Accounts receivable, net	433.0	386.5
Inventories	1,249.2	965.8
Prepaid expenses and other current assets	172.9	161.5
Deferred income taxes, net	216.9	230.4
Total current assets	4,569.6	3,794.9
Long-term investments	140.1	107.0
Equity and cost investments	414.3	372.3
Property, plant and equipment, net	2,444.2	2,355.0
Other assets	404.0	409.6
Goodwill	336.7	321.6
TOTAL ASSETS	$8,308.9	$7,360.4
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable	$402.2	$540.0
Accrued liabilities	935.6	940.9
Insurance reserves	159.6	145.6
Deferred revenue	520.8	449.3
Total current liabilities	2,018.2	2,075.8
Long-term debt	549.6	549.5
Other long-term liabilities	353.1	347.8
Total liabilities	2,920.9	2,973.1
Shareholders’ equity:		
Common stock ($0.001 par value) — authorized, 1,200.0 shares; issued and outstanding, 759.8 and 744.8 shares, respectively (includes 3.4 common stock units in both periods)	0.8	0.7
Additional paid-in capital	450.9	40.5
Retained earnings	4,935.8	4,297.4
Accumulated other comprehensive income	(2.5)	46.3
Total shareholders’ equity	5,385.0	4,384.9
Noncontrolling interests	3.0	2.4
Total equity	5,388.0	4,387.3
TOTAL LIABILITIES AND EQUITY	$8,308.9	$7,360.4

See Notes to Condensed Consolidated Financial Statements

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STARBUCKS CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in millions, unaudited)

	Three Quarters Ended	
	Jul 1, 2012	Jul 3, 2011
OPERATING ACTIVITIES:		
Net earnings including noncontrolling interests	$1,025.7	$889.9
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	427.7	408.2
Deferred income taxes, net	33.6	58.4
Income earned from equity method investees, net of distributions	(37.7)	(30.9)
Stock-based compensation	114.8	108.2
Other	10.0	20.8
Cash provided/(used) by changes in operating assets and liabilities:		
Inventories	(285.1)	(308.5)
Accounts payable	(139.1)	55.5
Accrued liabilities	(13.8)	(82.3)
Deferred revenue	71.8	73.5
Prepaid expenses, other current assets and other assets	(81.0)	(66.1)
Net cash provided by operating activities	1,126.9	1,126.7
INVESTING ACTIVITIES:		
Purchase of investments	(1,578.6)	(169.7)
Maturities and calls of investments	1,452.9	333.7
Acquisitions, net of cash acquired	(29.7)	—
Additions to property, plant and equipment, net	(516.5)	(372.4)
Other	(12.3)	(8.6)
Net cash used by investing activities	(684.2)	(217.0)
FINANCING ACTIVITIES:		
Purchase of noncontrolling interest	—	(27.5)
Proceeds from issuance of common stock	155.2	187.4
Excess tax benefit from exercise of stock options	156.5	87.3
Cash dividends paid	(384.0)	(292.1)
Repurchase of common stock	(15.7)	(321.9)
Other	(0.5)	(0.6)
Net cash used by financing activities	(88.5)	(367.4)
Effect of exchange rate changes on cash and cash equivalents	(1.0)	14.5
Net increase in cash and cash equivalents	353.2	556.8
CASH AND CASH EQUIVALENTS:		
Beginning of period	1,148.1	1,164.0
End of period	$1,501.3	$1,720.8
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid during the period for:		
Interest, net of capitalized interest	$17.2	$17.2
Income taxes	$311.4	$287.4

See Notes to Condensed Consolidated Financial Statements

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STARBUCKS CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

Note 1: Summary of Significant Accounting Policies

Financial Statement Preparation

The unaudited condensed consolidated financial statements as of July 1, 2012, and for the quarter and three quarters ended July 1, 2012 and July 3, 2011, have been prepared by Starbucks Corporation under the rules and regulations of the Securities and Exchange Commission ("SEC"). In the opinion of management, the financial information for the quarter and three quarters ended July 1, 2012 and July 3, 2011 reflects all adjustments and accruals, which are of a normal recurring nature, necessary for a fair presentation of the financial position, results of operations and cash flows for the interim periods. In this Quarterly Report on Form 10-Q ("10-Q") Starbucks Corporation is referred to as "Starbucks," the "Company," "we," "us" or "our".

The financial information as of October 2, 2011 is derived from our audited consolidated financial statements and notes for the fiscal year ended October 2, 2011 ("fiscal 2011"), included in Item 8 in the Fiscal 2011 Annual Report on Form 10-K (the "10-K"). The information included in this 10-Q should be read in conjunction with the footnotes and management's discussion and analysis of the financial statements in the 10-K.

In the second quarter of fiscal 2012, we renamed our Global Consumer Products Group ("CPG") segment "Channel Development."

The results of operations for the quarter and three quarters ended July 1, 2012 are not necessarily indicative of the results of operations that may be achieved for the entire fiscal year ending September 30, 2012 ("fiscal 2012").

Recent Accounting Pronouncements

In September 2011, the Financial Accounting Standards Board ("FASB") issued guidance that revises the requirements around how entities test goodwill for impairment. The guidance allows companies to perform a qualitative assessment before calculating the fair value of the reporting unit. If entities determine, on the basis of qualitative factors, that the fair value of the reporting unit is more likely than not greater than the carrying amount, a quantitative calculation would not be needed. We early-adopted this guidance effective for our fiscal 2012 annual goodwill impairment test, which we performed during the third fiscal quarter. The adoption of this guidance resulted in a change in how we performed our goodwill impairment assessment; however, it did not have a material impact on our financial statements.

In June 2011, the FASB issued guidance that revises the manner in which entities present comprehensive income in their financial statements. The guidance requires entities to report the components of comprehensive income in either a single, continuous statement or two separate but consecutive statements. The guidance will become effective for us at the beginning of our first quarter of fiscal 2013. The adoption of this new guidance will result in a change in how we present the components of comprehensive income, which is currently presented within our consolidated statements of equity.

In May 2011, the FASB issued guidance to amend the fair value measurement and disclosure requirements. The guidance requires the disclosure of quantitative information about unobservable inputs used, a description of the valuation processes used, and a qualitative discussion around the sensitivity of the measurements. The guidance became effective for us at the beginning of our second quarter of fiscal 2012. The adoption of this new guidance did not have a material impact on our financial statements.

Reclassifications

Change in shared service allocations

Effective at the beginning of fiscal 2012, we implemented the previously announced strategic realignment of our organizational structure designed to accelerate our global growth strategy. A president for each region, reporting directly to our chief executive officer, now oversees the company-operated retail business working closely with both the licensed and joint-venture business partners in each market. The regional presidents also work closely with our Channel Development team to continue building out our brands and channels in each region.

In connection with the changes to our organizational structure and reporting, we have changed the accountability for, and reporting of, certain indirect overhead costs. Certain indirect merchandising, manufacturing costs and back-office shared service costs, which were previously allocated to segment level costs of sales and operating expenses, are now managed at a corporate level and will be reported within unallocated corporate expenses. These expenses have therefore been removed from the segment level financial results. In order to conform prior period classifications with the new alignment, the historical

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consolidated financial statements have been recast with the following adjustments to previously reported amounts:

	Quarter Ended July 3, 2011			Three Quarters Ended July 3, 2011		
	As Filed	Reclass	As Adjusted	As Filed	Reclass	As Adjusted
Total net revenues	$2,932.2	$—	$2,932.2	$8,668.7	$—	$8,668.7
Cost of sales including occupancy costs	1,246.1	(8.6)	1,237.5	3,626.9	(25.9)	3,601.0
Store operating expenses	934.5	(17.4)	917.1	2,725.4	(53.2)	2,672.2
Other operating expenses	102.4	(2.4)	100.0	296.2	(7.2)	289.0
Depreciation and amortization expenses	129.5	—	129.5	386.1	—	386.1
General and administrative expenses	161.8	28.4	190.2	470.7	86.3	557.0
Total operating expenses	2,574.3	—	2,574.3	7,505.3	—	7,505.3
Income from equity investees	44.3	—	44.3	116.9	—	116.9
Operating income	$402.2	$—	$402.2	$1,280.3	$—	$1,280.3

There was no impact on consolidated net revenues, total operating expenses, operating income, or net earnings as a result of this change. Additional discussion regarding the change in our organizational structure and segment results is included at Note 12.

Note 2: Acquisition

On November 10, 2011, we acquired the outstanding shares of Evolution Fresh, Inc., a super-premium juice company, to expand our portfolio of product offerings and enter into the super-premium juice market. We acquired Evolution Fresh for a purchase price of $30 million in cash. The fair value of the net assets acquired on the acquisition date included $18 million of goodwill.

Evolution Fresh is its own operating segment and is reported in “Other” along with our Seattle’s Best Coffee operating segment, our Digital Ventures business, and unallocated corporate expenses.

Note 3: Derivative Financial Instruments

Foreign Currency

We enter into forward and swap contracts to hedge portions of cash flows of anticipated revenue streams and inventory purchases in currencies other than the entity's functional currency. Net derivative losses from cash flow hedges of $5.0 million and $11.1 million, net of taxes, were included in accumulated other comprehensive income as of July 1, 2012 and October 2, 2011, respectively. Of the net derivative losses accumulated as of July 1, 2012, $2.6 million pertains to derivative instruments that will be dedesignated as cash flow hedges within 12 months and will also continue to experience fair value changes before affecting earnings. Outstanding contracts will expire within 15 months.

We also enter into net investment derivative instruments to hedge our equity method investment in Starbucks Coffee Japan, Ltd., to minimize foreign currency exposure. Net derivative losses from net investment hedges of $31.2 million and $34.2 million, net of taxes, were included in accumulated other comprehensive income as of July 1, 2012 and October 2, 2011, respectively. Outstanding contracts will expire within 32 months.

In addition to the hedging instruments above, to mitigate the translation risk of certain balance sheet items, we enter into certain foreign currency swap contracts that are not designated as hedging instruments. These contracts are recorded at fair value, with the changes in fair value recognized in net interest income and other on the consolidated statements of earnings. Gains and losses from these instruments are largely offset by the financial impact of translating foreign currency denominated payables and receivables, which is also recognized in net interest income and other.

Coffee

Depending on market conditions, we also enter into futures contracts to hedge a portion of anticipated cash flows under our price-to-be-fixed green coffee contracts, which are described further in Note 5. Net derivative losses of $35.0 million, net of taxes, were included in accumulated other comprehensive income as of July 1, 2012 related to coffee hedges. Of the net derivative losses accumulated as of July 1, 2012, $22.2 million pertains to derivative instruments that will be dedesignated as cash flow hedges within 12 months and will also continue to experience fair value changes before affecting earnings. Outstanding contracts will expire within 13 months. There was insignificant coffee hedge activity in the first three quarters of fiscal 2011.

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Dairy

To mitigate the price uncertainty of a portion of our future purchases of dairy products, we enter into certain futures contracts that are not designated as hedging instruments. These contracts are recorded at fair value, with the changes in fair value recognized in net interest income and other. Gains and losses from these instruments are largely offset by price fluctuations on our dairy purchases which are included in cost of sales.

Diesel Fuel

To mitigate the price uncertainty of a portion of our future purchases of diesel fuel, we enter into certain swap contracts that are not designated as hedging instruments. These contracts are recorded at fair value, with the changes in fair value recognized in net interest income and other. Gains and losses from these instruments are largely offset by the financial impact of diesel fuel fluctuations on our shipping costs which are included in operating expenses.

The following tables present the pretax effect of derivative contracts designated as hedging instruments on earnings and other comprehensive income ("OCI") for the quarter and three quarters ended (in millions):

	Foreign Currency		Coffee	
Quarter Ended:	Jul 1, 2012	Jul 3, 2011	Jul 1, 2012	Jul 3, 2011
Cash Flow Hedges:				
Gain/(Loss) recognized in earnings	$(2.8)	$(4.7)	$(1.3)	$—
Gain/(Loss) recognized in OCI	$(1.9)	$(5.4)	$(20.6)	$0.1
Net Investment Hedges:				
Gain/(Loss) recognized in earnings	$—	$—		
Gain/(Loss) recognized in OCI	$(5.4)	$(5.2)		

	Foreign Currency		Coffee	
Three Quarters Ended:	Jul 1, 2012	Jul 3, 2011	Jul 1, 2012	Jul 3, 2011
Cash Flow Hedges:				
Gain/(Loss) recognized in earnings	$(8.6)	$(10.8)	$(1.3)	$—
Gain/(Loss) recognized in OCI	$1.0	$(13.4)	$(40.0)	$0.1
Net Investment Hedges:				
Gain/(Loss) recognized in earnings	$—	$—		
Gain/(Loss) recognized in OCI	$4.9	$(5.1)		

The amounts shown in the above tables as recognized in earnings for foreign currency and coffee hedges represent the realized gains/(losses) reclassified from OCI to net earnings during the year. The amounts shown as recognized in OCI are prior to these reclassifications.

The following table presents the pretax effect of derivative contracts not designated as hedging instruments on earnings for the quarter and three quarters ended (in millions):

	Foreign Currency		Dairy		Diesel Fuel	
	Jul 1, 2012	Jul 3, 2011	Jul 1, 2012	Jul 3, 2011	Jul 1, 2012	Jul 3, 2011
Gain/(Loss) recognized in earnings for the quarter ended	$4.2	$(0.3)	$1.2	$2.2	$(0.9)	$(0.2)
Gain/(Loss) recognized in earnings for the three quarters ended	$—	$(3.9)	$2.0	$5.0	$0.7	$1.1

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Notional amounts of outstanding derivative contracts as of July 1, 2012:
- $384 million in foreign currency contracts
- $183 million in coffee contracts
- $41 million in dairy contracts
- $29 million in diesel fuel contracts

Note 4: Fair Value Measurements
Assets and Liabilities Measured at Fair Value on a Recurring Basis (in millions):

		Fair Value Measurements at Reporting Date Using		
	Balance at July 1, 2012	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Short-term investments:				
Available-for-sale securities				
Agency obligations	$100.0	$ —	$ 100.0	$ —
Commercial paper	193.9	—	193.9	—
Corporate debt securities	80.8	—	80.8	—
Government treasury securities	499.6	499.6	—	—
Certificates of deposit	65.9	—	65.9	—
Total available-for-sale securities	940.2	499.6	440.6	—
Trading securities	56.1	56.1	—	—
Total short-term investments	996.3	555.7	440.6	—
Long-term investments:				
Agency obligations	4.0	—	4.0	—
Corporate debt securities	73.6	—	73.6	—
State and local government obligations	28.4	—	—	28.4
Certificates of deposit	34.1	—	34.1	—
Total long-term investments	140.1	—	111.7	28.4
Total	$1,136.4	$ 555.7	$ 552.3	$ 28.4
Liabilities:				
Short-term derivatives:				
Foreign Currency	$8.4	$ —	$ 8.4	$ —
Coffee	25.7	—	25.7	—
Total short-term derivatives	34.1	—	34.1	—
Long-term derivatives:				
Foreign Currency	2.3	—	2.3	—
Coffee	3.8	—	3.8	—
Total long-term derivatives	6.1	—	6.1	—
Total	$40.2	$ —	$ 40.2	$ —

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		Fair Value Measurements at Reporting Date Using		
	Balance at October 2, 2011	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Short-term investments:				
Available-for-sale securities				
Agency obligations	$20.0	$ —	$ 20.0	$ —
Commercial paper	87.0	—	87.0	—
Corporate debt securities	78.0	—	78.0	—
Government treasury securities	606.0	606.0	—	—
Certificates of deposit	64.0	—	64.0	—
Total available-for-sale securities	855.0	606.0	249.0	—
Trading securities	47.6	47.6	—	—
Total short-term investments	902.6	653.6	249.0	—
Long-term investments:				
Corporate debt securities	67.0	—	67.0	—
State and local government obligations	28.0	—	—	28.0
Certificates of deposit	12.0	—	12.0	—
Total long-term investments	107.0	—	79.0	28.0
Total	$1,009.6	$ 653.6	$ 328.0	$ 28.0
Liabilities:				
Short-term derivatives:				
Foreign Currency	$20.1	$ —	$ 20.1	$ —
Coffee	1.2	—	1.2	—
Total short-term derivatives	21.3	—	21.3	—
Long-term derivatives:				
Foreign Currency	9.9	—	9.9	—
Total long-term derivatives	9.9	—	9.9	—
Total	$31.2	$ —	$ 31.2	$ —

Short-term and long-term derivatives are included in other accrued liabilities, and other long-term liabilities, respectively.

Gross unrealized holding gains and losses were not material as of July 1, 2012 and October 2, 2011.

Changes in Level 3 Instruments Measured at Fair Value on a Recurring Basis

Financial instruments measured using Level 3 inputs described above are comprised entirely of our auction rate securities (“ARS”).

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

Assets and liabilities recognized or disclosed at fair value in the financial statements on a nonrecurring basis include items such as property, plant and equipment, goodwill and other intangible assets, equity and cost method investments, and other assets. These assets are measured at fair value if determined to be impaired.

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During the quarter and three quarters ended July 1, 2012 and July 3, 2011, we recognized fair market value adjustments with a charge to earnings for these assets as follows (in millions):

	Quarter Ended July 1, 2012			Three Quarters Ended July 1, 2012		
	Carrying Value before adjustment	Fair value adjustment	Carrying value after adjustment	Carrying Value before adjustment	Fair value adjustment	Carrying value after adjustment
Property, plant and equipment (1)	$1.1	$(0.7)	$0.4	$4.4	$(2.7)	$1.7

	Quarter Ended July 3, 2011			Three Quarters Ended July 3, 2011		
	Carrying Value before adjustment	Fair value adjustment	Carrying value after adjustment	Carrying Value before adjustment	Fair value adjustment	Carrying