

STARBUCKS CORP  
Form 10-Q  
August 10, 2007

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**  
**Washington, DC 20549**  
**FORM 10-Q**

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934**

**For the Quarterly Period Ended July 1, 2007**

**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**

(State or Other Jurisdiction of  
Incorporation or Organization)

**91-1325671**

(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 ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer" and "large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☒ Accelerated filer ☐ Non-accelerated filer ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act):

Yes ☐ No ☒

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 August 6, 2007

Common Stock, par value \$0.001 per share

746,293,550

**STARBUCKS CORPORATION**  
**FORM 10-Q**  
**For the Quarterly Period Ended July 1, 2007**  
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**STARBUCKS CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS**

*(in thousands, except earnings per share)*  
*(unaudited)*

	13 Weeks Ended		39 Weeks Ended	
	July 1, 2007	July 2, 2006	July 1, 2007	July 2, 2006
Net revenues:				
Company-operated retail	\$ 2,010,772	\$ 1,660,977	\$ 5,940,288	\$ 4,888,804
Specialty:				
Licensing	254,904	216,267	743,633	637,771
Foodservice and other	93,569	86,429	286,641	257,012
Total specialty	348,473	302,696	1,030,274	894,783
Total net revenues	2,359,245	1,963,673	6,970,562	5,783,587
Cost of sales including occupancy costs	1,003,881	804,889	2,933,450	2,343,800
Store operating expenses	819,212	686,602	2,372,164	1,974,041
Other operating expenses	76,507	69,478	224,706	192,274
Depreciation and amortization expenses	119,409	98,539	342,990	284,335
General and administrative expenses	119,525	115,258	360,857	358,194
Subtotal operating expenses	2,138,534	1,774,766	6,234,167	5,152,644
Income from equity investees	24,503	25,666	69,517	65,371
Operating income	245,214	214,573	805,912	696,314
Net interest and other (expense)/income	(2,241)	5,028	3,606	8,439
Earnings before income taxes	242,973	219,601	809,518	704,753
Income taxes	84,630	74,103	295,383	257,783
Net earnings	\$ 158,343	\$ 145,498	\$ 514,135	\$ 446,970
Net earnings per common share basic	\$ 0.21	\$ 0.19	\$ 0.68	\$ 0.58
Net earnings per common share diluted	\$ 0.21	\$ 0.18	\$ 0.66	\$ 0.56
Weighted average shares outstanding:				
Basic	744,473	769,825	751,694	768,108
Diluted	763,559	798,259	773,506	795,285

*See Notes to Condensed Consolidated Financial Statements.*

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**STARBUCKS CORPORATION**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
*(in thousands, except share data)*  
*(unaudited)*

	July 1, 2007	October 1, 2006
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 172,789	\$ 312,606
Short-term investments available-for-sale securities	85,956	87,542
Short-term investments trading securities	71,278	53,496
Accounts receivable, net of allowances of \$5,252 and \$3,827, respectively	250,866	224,271
Inventories	657,466	636,222
Prepaid expenses and other current assets	128,370	126,874
Deferred income taxes, net	101,071	88,777
Total current assets	1,467,796	1,529,788
Long-term investments available-for-sale securities	15,980	5,811
Equity and other investments	242,460	219,093
Property, plant and equipment, net	2,686,969	2,287,899
Other assets	235,107	186,917
Other intangible assets	40,392	37,955
Goodwill	215,219	161,478
<b>TOTAL ASSETS</b>	<b>\$ 4,903,923</b>	<b>\$ 4,428,941</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Commercial paper and short-term borrowings	\$ 879,972	\$ 700,000
Accounts payable	314,583	340,937
Accrued compensation and related costs	324,915	288,963
Accrued occupancy costs	75,916	54,868
Accrued taxes	84,233	94,010
Other accrued expenses	233,313	224,154
Deferred revenue	309,714	231,926
Current portion of long-term debt	772	762
Total current liabilities	2,223,418	1,935,620
Long-term debt	1,356	1,958
Other long-term liabilities	323,364	262,857
Total liabilities	2,548,138	2,200,435
Shareholders' equity:		

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Common stock (\$0.001 par value) authorized, 1,200,000,000 shares; issued and outstanding, 745,303,613 and 756,602,055 shares, respectively (includes 3,394,184 common stock units in both periods)	745	756
Other additional paid-in-capital	39,393	39,393
Retained earnings	2,264,992	2,151,084
Accumulated other comprehensive income	50,655	37,273
Total shareholders' equity	2,355,785	2,228,506
 TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	 \$ 4,903,923	 \$ 4,428,941

*See Notes to Condensed Consolidated Financial Statements.*

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**STARBUCKS CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
*(in thousands and unaudited)*

	39 Weeks Ended	
	July 1, 2007	July 2, 2006
<b>OPERATING ACTIVITIES:</b>		
Net earnings	\$ 514,135	\$ 446,970
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	360,881	303,210
Provision for impairments and asset disposals	21,165	12,017
Deferred income taxes, net	(40,459)	(75,094)
Equity in income of investees	(38,621)	(40,989)
Distributions of income from equity investees	42,324	37,499
Stock-based compensation	78,530	78,698
Tax benefit from exercise of stock options	5,865	908
Excess tax benefit from exercise of stock options	(52,034)	(93,327)
Net amortization of premium on securities	604	1,643
Cash provided/(used) by changes in operating assets and liabilities:		
Inventories	(16,734)	(6,672)
Accounts payable	(30,944)	27,549
Accrued compensation and related costs	32,374	58,535
Accrued taxes	38,040	85,308
Deferred revenue	76,944	60,085
Other operating assets and liabilities	47,770	39,434
Net cash provided by operating activities	1,039,840	935,774
<b>INVESTING ACTIVITIES:</b>		
Purchase of available-for-sale securities	(207,974)	(529,764)
Maturity of available-for-sale securities	162,212	193,184
Sale of available-for-sale securities	36,897	291,878
Acquisitions, net of cash acquired	(53,419)	(90,578)
Net purchases of equity, other investments and other assets	(48,363)	(19,938)
Net additions to property, plant and equipment	(772,133)	(522,348)
Net cash used by investing activities	(882,780)	(677,566)
<b>FINANCING ACTIVITIES:</b>		
Repayments of commercial paper	(3,795,450)	
Proceeds from issuance of commercial paper	4,675,422	
Repayments of short-term borrowings	(1,370,000)	(455,000)
Proceeds from short-term borrowings	670,000	378,000
Proceeds from issuance of common stock	136,603	131,824
Excess tax benefit from exercise of stock options	52,034	93,327
Principal payments on long-term debt	(592)	(560)
Repurchase of common stock	(670,988)	(367,771)
Net cash used by financing activities	(302,971)	(220,180)

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Effect of exchange rate changes on cash and cash equivalents	6,094	3,902
Net increase/(decrease) in cash and cash equivalents	(139,817)	41,930
<b>CASH AND CASH EQUIVALENTS:</b>		
Beginning of period	312,606	173,809
End of period	\$ 172,789	\$ 215,739
<b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:</b>		
Cash paid during the period for:		
Interest	\$ 25,372	\$ 4,892
Income taxes	\$ 294,624	\$ 239,004

*See Notes to Condensed Consolidated Financial Statements.*



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**STARBUCKS CORPORATION**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
***For the 13 Weeks and 39 Weeks Ended July 1, 2007, and July 2, 2006***  
***(unaudited)***

**Note 1: Summary of Significant Accounting Policies**

*Financial Statement Preparation*

The unaudited condensed consolidated financial statements as of July 1, 2007, and for the 13-week periods and 39-week periods ended July 1, 2007, and July 2, 2006, have been prepared by Starbucks Corporation ( Starbucks or the Company ) under the rules and regulations of the Securities and Exchange Commission (the SEC ). In the opinion of management, the financial information for the 13-week periods and 39-week periods ended July 1, 2007, and July 2, 2006, 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.

The financial information as of October 1, 2006, is derived from the Company s audited consolidated financial statements and notes for the fiscal year ended October 1, 2006 ( Fiscal 2006 ), included in Item 8 in the Fiscal 2006 Annual Report on Form 10-K (together with Amendment No. 1 to the Fiscal 2006 Annual Report on Form 10-K/A, the 10-K ). The information included in this Form 10-Q should be read in conjunction with management s discussion and analysis and notes to the financial statements in the 10-K.

The results of operations for the 13-week period and 39-week period ended July 1, 2007, are not necessarily indicative of the results of operations that may be achieved for the entire fiscal year ending September 30, 2007.

*Recent Accounting Pronouncements*

In June 2006, the Financial Accounting Standards Board ( FASB ) issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109 ( FIN 48 ), which seeks to reduce the diversity in practice associated with the accounting and reporting for uncertainty in income tax positions. This Interpretation prescribes a comprehensive model for the financial statement recognition, measurement, presentation and disclosure of uncertain tax positions taken or expected to be taken in income tax returns. FIN 48 is effective for fiscal years beginning after December 15, 2006, and the Company will adopt the new requirements in its first fiscal quarter of 2008. The cumulative effects, if any, of adopting FIN 48 will be recorded as an adjustment to retained earnings as of the beginning of the period of adoption. The Company is currently evaluating the impact, if any, of adopting FIN 48 on its consolidated financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standard ( SFAS ) No. 157, Fair Value Measurements ( SFAS 157 ), which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. Early adoption is permitted. Starbucks must adopt these new requirements no later than its first fiscal quarter of 2009. Starbucks has not yet determined the effect on the Company s consolidated financial statements, if any, upon adoption of SFAS 157, or if it will adopt the requirements prior to the first fiscal quarter of 2009.

In September 2006, the SEC staff issued Staff Accounting Bulletin No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements ( SAB 108 ). The intent of SAB 108 is to reduce diversity in practice for the method companies use to quantify financial statement misstatements, including the effect of prior year uncorrected errors. SAB 108 establishes an approach that requires quantification of financial statement errors using both an income statement and cumulative balance sheet approach. SAB 108 is effective for annual financial statements for fiscal years ending after November 15, 2006. The adoption

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of SAB 108 is not expected to have a significant impact on the Company's consolidated financial statements. In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" (SFAS 159). SFAS 159 permits companies to choose to measure many financial instruments and certain other items at fair value. SFAS 159 is effective for financial statements issued for fiscal years beginning after November 15, 2007, or Starbucks first fiscal quarter of 2009. Early adoption is permitted. Starbucks has not yet determined if it will elect to apply any of the provisions of SFAS 159 or what the effect of adoption of the statement would have, if any, on its consolidated financial statements.

### **Note 2: Acquisition**

In the first quarter of fiscal 2007, the Company purchased a 90% stake in its previously-licensed operations in Beijing and Tianjin, China. Due to its majority ownership of these operations, Starbucks applied the consolidation method of accounting subsequent to the date of acquisition.

### **Note 3: Derivative Financial Instruments**

The Company manages its exposure to various risks within the consolidated financial statements according to an umbrella risk policy. Under this policy, Starbucks may engage in transactions involving various derivative instruments, with maturities generally not longer than five years, to hedge assets, liabilities, revenues and purchases.

#### *Cash Flow Hedges*

Starbucks, which includes subsidiaries that use their local currency as their functional currency, enters into cash flow derivative instruments to hedge portions of anticipated revenue streams and inventory purchases. Current forward contracts, which comprise the majority of the Company's derivative instruments, hedge monthly forecasted revenue transactions denominated in Japanese yen and Canadian dollars, as well as forecasted inventory purchases denominated primarily in U.S. dollars for foreign operations. The Company also has futures contracts to hedge the variable price component for a small portion of its price-to-be-fixed green coffee purchase contracts.

The Company had accumulated net derivative losses of \$2.9 million, net of taxes, in other comprehensive income as of July 1, 2007, related to cash flow hedges. Of this amount, \$1.5 million of net derivative losses pertain to hedging instruments that will be dedesignated within 12 months and will also continue to experience fair value changes before affecting earnings. There was no significant ineffectiveness for cash flow hedges recognized during the 13-week and 39-week periods ended July 1, 2007. No cash flow hedges were discontinued and no ineffectiveness was recognized during the 13-week and 39-week periods ended July 2, 2006. Current contracts will expire within 27 months.

#### *Net Investment Hedges*

Net investment derivative instruments are used to hedge the Company's equity method investment in Starbucks Coffee Japan, Ltd. (Starbucks Japan) as well as the Company's net investments in its Canadian, United Kingdom, and Chinese subsidiaries, to minimize foreign currency exposure. The Company applies the spot-to-spot method for these forward foreign exchange contracts, and under this method the change in fair value of the forward contracts attributable to the changes in spot exchange rates (the effective portion) is reported in other comprehensive income. The remaining change in fair value of the forward contract (the ineffective portion) is reclassified into earnings in Net interest and other (expense)/income. The Company had accumulated net derivative losses of \$6.0 million, net of taxes, in other comprehensive income as of July 1, 2007, related to net investment derivative hedges. Current contracts expire within 33 months.

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The following table presents the net gains and losses reclassified from other comprehensive income into the consolidated statements of earnings during the periods indicated for cash flow and net investment hedges (*in thousands*):

	13 Weeks Ended		39 Weeks Ended	
	July 1, 2007	July 2, 2006	July 1, 2007	July 2, 2006
Cash flow hedges:				
Reclassified gains into total net revenues	\$ 475	\$ 169	\$ 1,465	\$ 1,041
Reclassified losses into cost of sales	(38)	(1,924)	(1,113)	(5,492)
Net reclassified gains/(losses) cash flow hedges	437	(1,755)	352	(4,451)
Net reclassified gains net investment hedges	1,189	706	3,806	1,705
Total	\$1,626	\$(1,049)	\$ 4,158	\$(2,746)

**Other Derivatives**

Starbucks entered into foreign currency forward contracts that are not designated as hedging instruments for accounting purposes. These contracts are recorded at fair value, with the changes in fair value recognized in Net interest and other (expense)/income on the consolidated statements of earnings. For the 13-week and 39-week periods ended July 1, 2007, these forward contracts resulted in net losses of \$3.6 million and \$5.9 million, respectively. These losses were largely offset by the financial impact of translating certain foreign currency denominated payables and receivables, which are also recognized in Net interest and other (expense)/income. No similar contracts were held as of July 2, 2006.

**Note 4: Inventories**

Inventories consist of the following (*in thousands*):

	July 1, 2007	October 1, 2006	July 2, 2006
Coffee:			
Unroasted	\$ 362,371	\$ 328,051	\$ 324,254
Roasted	74,399	80,199	71,580
Other merchandise held for sale	130,740	146,345	81,224
Packaging and other supplies	89,956	81,627	80,301
Total	\$ 657,466	\$ 636,222	\$ 557,359

Other merchandise held for sale includes, among other items, brewing equipment, serveware and tea. As of July 1, 2007, the Company had committed to fixed-price purchase contracts for green coffee totaling \$374 million. The Company believes, based on relationships established with its suppliers in the past, the risk of non-delivery on such purchase commitments is remote.

**Table of Contents****Note 5: Property, Plant and Equipment**

Property, plant and equipment are recorded at cost and consist of the following (*in thousands*):

	July 1, 2007	October 1, 2006
Land	\$ 39,992	\$ 32,350
Buildings	147,134	109,129
Leasehold improvements	2,930,396	2,436,503
Store equipment	946,065	784,444
Roasting equipment	205,854	197,004
Furniture, fixtures and other	558,987	523,275
	4,828,428	4,082,705
Less: accumulated depreciation and amortization	(2,314,071)	(1,969,804)
	2,514,357	2,112,901
Work in progress	172,612	174,998
Property, plant and equipment, net	\$ 2,686,969	\$ 2,287,899

**Note 6: Short-term Borrowings**

In August 2005, the Company entered into a \$500 million unsecured five-year revolving credit facility (the "facility") with various banks, of which \$100 million may be used for issuances of letters of credit. The facility is available for working capital, capital expenditures and other corporate purposes, which may include acquisitions and share repurchases. In August 2006, the Company increased its borrowing capacity under the facility to \$1 billion, as provided in the original credit facility. In December 2006, the Company extended the term of the facility by one year to August 2011. The interest rate for borrowings under the facility ranges from 0.11% to 0.27% over LIBOR or an alternate base rate, which is the greater of the bank prime rate or the Federal Funds Rate plus 0.50%. The specific spread over LIBOR will depend upon the Company's performance under specified financial criteria. The facility contains provisions requiring the Company to maintain compliance with certain covenants, including the maintenance of certain financial ratios. As of July 1, 2007 and October 1, 2006, the Company was in compliance with each of these covenants.

On March 27, 2007, the Company established a commercial paper program (the "program"). Under the program, the Company may issue unsecured commercial paper notes, up to a maximum aggregate amount outstanding at any time of \$1 billion, with individual maturities that may vary, but not exceed 397 days from the date of issue. The program is backstopped by the Company's revolving facility, and the combined borrowing limit is \$1 billion for the program and the facility. Under the program, the Company may issue commercial paper from time to time, and the proceeds of the commercial paper financing will be used for working capital, capital expenditures and other corporate purposes, which may include acquisitions and share repurchases.

As of July 1, 2007, the Company had no amount outstanding under the credit facility, although a letter of credit of \$12.9 million was outstanding, which reduces the borrowing capacity under the credit facility. As of July 1, 2007, the Company had commercial paper outstanding totaling \$880 million. As of October 1, 2006, the Company had \$700 million outstanding under the credit facility, as well as a letter of credit of \$11.9 million. The weighted average contractual interest rates were 5.4% at July 1, 2007 on commercial paper outstanding and 5.5% at October 1, 2006 on borrowings under the facility.

Interest expense, net of interest capitalized, was \$10.9 million and \$24.6 million for the 13 weeks and 39 weeks ended July 1, 2007, respectively. Interest expense was \$0.7 million and \$5.1 million for the 13 weeks and 39 weeks ended July 2, 2006, respectively. For the 13 weeks and 39 weeks ended July 1, 2007, \$1.1 million and \$3.0 million, respectively, of interest expense was capitalized. No interest was capitalized for the 13 weeks and 39 weeks ended

July 2, 2006.

**Table of Contents****Note 7: Other Long-term Liabilities**

The Company's other long-term liabilities consist of the following (*in thousands*):

	July 1, 2007	October 1, 2006
Deferred rent	\$ 247,202	\$ 203,903
Asset retirement obligations	41,993	34,271
Minority interest	16,030	10,739
Other	18,139	13,944
Total	\$ 323,364	\$ 262,857

Deferred rent liabilities represent amounts for tenant improvement allowances, rent escalation clauses and rent holidays related to certain operating leases. The Company amortizes deferred rent over the terms of the leases as reductions to rent expense on the consolidated statements of earnings.

Asset retirement obligations represent the estimated fair value of the Company's future costs of removing leasehold improvements at the termination of leases for certain stores and administrative facilities.

Minority interest represents the collective ownership interests of minority shareholders for operations accounted for under the consolidation method, in which Starbucks owns less than 100% of the equity interest.

The other remaining long-term liabilities generally include obligations to be settled or paid for one year beyond each period presented, for items such as hedging instruments, guarantees, the long-term portion of capital lease obligations and donation commitments.

**Note 8: Shareholders' Equity**

In addition to 1.2 billion shares of authorized common stock with \$0.001 par value per share, the Company has authorized 7.5 million shares of preferred stock, none of which was outstanding at July 1, 2007.

Under the Company's authorized share repurchase program, Starbucks acquired 20.3 million shares at a cost of \$671 million, for an average price of \$32.97 during the 39-week period ended July 1, 2007. Starbucks acquired 11.1 million shares at an average price of \$32.03 for a total accrual-based cost of \$354 million during the 39-week period ended July 2, 2006. The related cash amount used to repurchase shares for the 39-week period ended July 2, 2006 was \$368 million. The difference between the two amounts represents the effect of the net change in unsettled trades totaling \$14 million from October 2, 2005. There was no change in the amount of unsettled trades from October 1, 2006 to July 1, 2007. Share repurchases were funded through cash, cash equivalents, available-for-sale securities as well as borrowings under the revolving credit facility and commercial paper program, and were part of the Company's active capital management program. On May 1, 2007, the Starbucks Board of Directors authorized the repurchase of up to 25 million additional shares of the Company's common stock. As of July 1, 2007, a total of up to 26.1 million shares remained available for repurchase, under the current and previous authorizations.

***Comprehensive Income***

Comprehensive income includes all changes in equity during the period, except those resulting from transactions with shareholders and subsidiaries of the Company. It has two components: net earnings and other comprehensive income. Accumulated other comprehensive income reported on the Company's consolidated balance sheets consists of foreign currency translation adjustments and the unrealized gains and losses, net of applicable taxes, on available-for-sale securities and on derivative instruments designated and qualifying as cash flow and net investment hedges.

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Comprehensive income, net of related tax effects, is as follows (*in thousands*):

	13 Weeks Ended		39 Weeks Ended	
	July 1, 2007	July 2, 2006	July 1, 2007	July 2, 2006
Net earnings	\$158,343	\$145,498	\$514,135	\$446,970
Unrealized holding (losses) on cash flow hedging instruments	(4,411)	(3,769)	(415)	(4,467)
Unrealized holding (losses) on net investment hedging instruments	(1,681)	(1,654)	(2,767)	(410)
Unrealized holding gains on available-for-sale securities	37	835	199	1,702
Reclassification adjustment for net (gains)/losses realized in net earnings for available-for-sale securities		(1,095)	1	(1,089)
Reclassification adjustment for net (gains)/losses realized in net earnings for cash flow hedges	(413)	830	696	2,846
Net unrealized (loss)	(6,468)	(4,853)	(2,286)	(1,418)
Translation adjustment	6,746	15,586	15,668	17,416
Total comprehensive income	\$158,621	\$156,231	\$527,517	\$462,968

The favorable translation adjustment change for the 13-week period ended July 1, 2007, of \$6.7 million was primarily due to the weakening of the U.S. dollar against the Canadian dollar. The favorable translation adjustment change for the 13-week period ended July 2, 2006, of \$15.6 million was primarily due to the weakening of the U.S. dollar against several currencies including the euro, British pound sterling, Japanese yen and Canadian dollar.

The favorable translation adjustment change for the 39-week period ended July 1, 2007, of \$15.7 million was primarily due to the weakening of the U.S. dollar against several currencies including the euro and British pound sterling. The favorable translation adjustment change for the 39-week period ended July 2, 2006, of \$17.4 million was primarily due to the weakening of the U.S. dollar against several currencies including the euro, British pound sterling, Canadian dollar and Korean won.

The components of accumulated other comprehensive income, net of tax, as presented on the consolidated balance sheets were as follows (*in thousands*):

	July 1, 2007	October 1, 2006
Net unrealized holding (losses) on available-for-sale securities	\$ (54)	\$ (254)
Net unrealized holding (losses) on hedging instruments	(8,902)	(6,416)
Translation adjustment	59,611	43,943
Accumulated other comprehensive income	\$ 50,655	\$ 37,273

As of July 1, 2007, the translation adjustment of \$59.6 million was net of tax provisions of \$7.8 million. As of October 1, 2006, the translation adjustment of \$43.9 million was net of tax provisions of \$7.3 million.

**Table of Contents****Note 9: Stock-Based Compensation***Stock Options*

Stock options to purchase the Company's common stock are granted at the fair market value of the stock on the date of grant. The majority of options become exercisable in four equal installments beginning a year from the date of grant and generally expire 10 years from the date of grant. Certain options granted prior to October 1, 2006 become exercisable in three equal installments beginning a year from the date of grant. Options granted to non-employee directors generally vest over one year. Nearly all outstanding stock options are non-qualified stock options. The fair value of stock awards was estimated at the date of grant using the Black-Scholes-Merton option valuation model with the following weighted average assumptions for the 13-week and 39-week periods ended July 1, 2007, and July 2, 2006:

	Employee Stock Options Granted During the Period 13 Weeks Ended		39 Weeks Ended	
	July 1, 2007	July 2, 2006	July 1, 2007	July 2, 2006
Expected term (in years)	4.5	4.4	4.7	4.4
Expected stock price volatility	26.6%	28.7%	29.0%	28.9%
Risk-free interest rate	4.7%	5.0%	4.6%	4.4%
Expected dividend yield	0.0%	0.0%	0.0%	0.0%
Estimated fair value per option granted	\$8.70	\$11.87	\$11.86	\$9.58

The assumptions used to calculate the fair value of stock awards granted are evaluated and revised, as necessary, to reflect market conditions and the Company's experience.

For the 39-week periods ended July 1, 2007 and July 2, 2006, total pretax compensation cost recognized for share-based payment plans was \$78.5 million and \$78.0 million, respectively, and the total income tax benefit recognized in the consolidated statements of earnings from these plans was \$26.6 million for each period.

The following summarizes all stock option transactions from October 1, 2006 through July 1, 2007 (no restricted stock, restricted stock units or stock appreciation rights were outstanding for any of these periods):

	Shares Subject to Options	Weighted Average Exercise Price per Share	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value (in thousands)
Outstanding, October 1, 2006	69,419,871	\$16.83	6.2	\$1,196,209
Granted	11,829,690	36.38		
Exercised	(7,658,022)	13.20		
Forfeited/Cancelled	(2,649,028)	30.77		
Outstanding, July 1, 2007	70,942,511	19.97	6.1	613,392
Exercisable, July 1, 2007	45,263,707	13.60	4.7	593,216
Vested and expected to vest, July 1, 2007	69,069,845	19.56	6.0	613,318

The aggregate intrinsic value in the table above is the amount by which the market value of the underlying stock exceeded the exercise price of outstanding options, is before applicable income taxes and represents the amount optionees would have realized if all in-the-money options had been exercised on the last business day of the period indicated. As of July 1, 2007, total unrecognized stock-based compensation expense related to nonvested stock options was approximately \$122 million, before income taxes, and is expected to be recognized over a weighted average period of approximately 24 months.





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The Company issues new shares of common stock upon exercise of stock options. As of July 1, 2007, there were 59.1 million shares of common stock available for issuance pursuant to future stock option grants.

**Note 10: Earnings Per Share**

The following table presents the calculation of net earnings per common share basic and diluted (*in thousands, except earnings per share*):

	13 Weeks Ended		39 Weeks Ended	
	July 1, 2007	July 2, 2006	July 1, 2007	July 2, 2006
Net earnings	\$158,343	\$145,498	\$514,135	\$446,970
Weighted average common shares and common stock units outstanding (for basic calculation)	744,473	769,825	751,694	768,108
Dilutive effect of outstanding common stock options	19,086	28,434	21,812	27,177
Weighted average common and common equivalent shares outstanding (for diluted calculation)	763,559	798,259	773,506	795,285
Net earnings per common share basic	\$ 0.21	\$ 0.19	\$ 0.68	\$ 0.58
Net earnings per common and common equivalent share diluted	\$ 0.21	\$ 0.18	\$ 0.66	\$ 0.56

Potential dilutive shares consist of the incremental common shares issuable upon the exercise of outstanding stock options (both vested and non-vested) using the treasury stock method. These options are excluded from the computation of earnings per share if their effect is antidilutive. The antidilutive options totaled 21.7 million and 433 thousand for the 13-week periods ended July 1, 2007 and July 2, 2006, respectively. The antidilutive options totaled 9.6 million and 10.0 million for the 39-week periods ended July 1, 2007 and July 2, 2006, respectively.

**Note 11: Commitments and Contingencies***Guarantees*

The Company has unconditionally guaranteed the repayment of certain Japanese yen-denominated bank loans and related interest and fees of an unconsolidated equity investee, Starbucks Japan. The guarantees continue until the loans, including accrued interest and fees, have been paid in full, with the final loan amount due in 2014. The maximum amount is limited to the sum of unpaid principal and interest amounts, as well as other related expenses. These amounts will vary based on fluctuations in the yen foreign exchange rate. As of July 1, 2007, the maximum amount of the guarantees was approximately \$5.1 million. Since there has been no modification of these loan guarantees subsequent to the Company's adoption of FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indebtedness of Others*, Starbucks has applied the disclosure provisions only and has not recorded the guarantee on its consolidated balance sheet.

Starbucks has commitments under which it unconditionally guarantees its proportionate share of certain borrowings of unconsolidated equity investees. The Company's maximum exposure under these commitments is approximately \$9.4 million, excluding interest and other related costs, and these commitments expire between 2007 and 2012. As of July 1, 2007, the Company had a total of \$3.6 million in *Equity and other investments* and *Other long-term liabilities* on the consolidated balance sheet for the fair value of the guarantee arrangements.

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*Legal Proceedings*

On June 3, 2004, two then-current employees of the Company filed a lawsuit, entitled *Sean Pendlebury and Laurel Overton v. Starbucks Coffee Company*, in the U.S. District Court for the Southern District of Florida claiming the Company violated requirements of the Fair Labor Standards Act ( FLSA ). The suit alleges that the Company misclassified its retail store managers as exempt from the overtime provisions of the FLSA, and that each manager therefore is entitled to overtime compensation for any week in which he or she worked more than 40 hours during the three years before joining the suit as a plaintiff, and for as long as they remain a manager thereafter. Plaintiffs seek to represent themselves and all similarly situated U.S. current and former store managers of the Company. Plaintiffs seek reimbursement for an unspecified amount of unpaid overtime compensation, liquidated damages, attorneys fees and costs. Plaintiffs also filed on June 3, 2004 a motion for conditional collective action treatment and court-supervised notice to additional putative class members under the opt-in procedures in section 16(b) of the FLSA. On January 3, 2005, the district court entered an order authorizing nationwide notice of the lawsuit to all current and former store managers employed by the Company during the three years before the suit was filed. The Company filed a motion for summary judgment as to the claims of the named plaintiffs on September 24, 2004. The court denied that motion because this case was in the early stages of discovery, but the court noted that the Company may resubmit this motion at a later date. Starbucks believes that the plaintiffs are properly classified as exempt under the federal wage laws. The Company cannot estimate the possible loss to the Company, if any, and believes that a loss in this case is unlikely. There is currently no trial date. The Company intends to vigorously defend the lawsuit.

On October 8, 2004, a former hourly employee of the Company filed a lawsuit in San Diego County Superior Court entitled *Jou Chau v. Starbucks Coffee Company*. The lawsuit alleges that the Company violated the California Labor Code by allowing shift supervisors to receive tips. More specifically, the lawsuit alleges that since shift supervisors direct the work of baristas, they qualify as agents of the Company and are therefore excluded from receiving tips under California Labor Code Section 351, which prohibits employers and their agents from collecting or receiving tips left by patrons for other employees. The lawsuit further alleges that because the tipping practices violate the Labor Code, they also are unfair practices under the California Unfair Competition Law. In addition to recovery of an unspecified amount of tips distributed to shift supervisors, the lawsuit seeks penalties under California Labor Code Section 203 for willful failure to pay wages due. Plaintiff also seeks attorneys fees and costs. On March 30, 2006, the Court issued an order certifying the case as a class action, with the plaintiff representing a class of all persons employed as baristas in the state of California since October 8, 2000. In March 2007, notice of action was sent to approximately 120,000 potential members of the class. The Company cannot estimate the possible loss to the Company, if any. Trial is currently set for December 2007. The Company believes its practices comply with California law, and the Company intends to vigorously defend the lawsuit.

On March 11, 2005, a former employee of the Company filed a lawsuit, entitled *James Falcon v. Starbucks Corporation and Does 1 through 100*, in the U.S. District Court for the Southern District of Texas claiming that the Company violated requirements of the FLSA. Specifically, the plaintiff claims that the Company misclassified its retail assistant store managers as exempt from the overtime provisions of the FLSA and that each assistant manager therefore is entitled to overtime compensation for any week in which he or she worked more than 40 hours during the three years before joining the suit as a plaintiff, and for as long as they remain an assistant manager thereafter. On August 18, 2005, the plaintiff amended his complaint to include allegations that he and other retail assistant store managers were not paid overtime compensation for all hours worked in excess of 40 hours in a work week after they were re-classified as non-exempt employees in September 2002. In both claims, Plaintiff seeks to represent himself and a putative class of all current and former assistant store managers employed by the Company in the United States from March 11, 2002 until the present. He also seeks, on behalf of himself and the class, reimbursement for an unspecified amount of unpaid overtime compensation, liquidated damages, injunctive relief, and attorneys fees and costs. On September 13, 2005, the plaintiff filed a motion for conditional collective action treatment and court-supervised notice to all putative class members under the opt-in procedures in section 16(b) of the FLSA. On November 29, 2005, the court entered an order authorizing notice to the class of the existence of the lawsuit and

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their opportunity to join as plaintiffs. The Company has a policy requiring that all non-exempt partners, including assistant store managers, be paid for all hours worked, including any hours worked in excess of 40 per week. The Company also believes that this policy is, and at all relevant times has been, communicated and followed consistently. Further, the Company believes that the plaintiff and other assistant store managers were properly classified as exempt under the FLSA prior to September 2002. The Company cannot estimate the possible loss to the Company, if any, and believes that a loss in this case is unlikely. No trial date has been set. The Company intends to vigorously defend the lawsuit.

The Company is party to various other legal proceedings arising in the ordinary course of its business, but it is not currently a party to any legal proceeding that management believes would have a material adverse effect on the consolidated financial position or results of operations of the Company.

**Note 12: Segment Reporting**

Segment information is prepared on the basis that the Company's management reviews financial information for operational decision making purposes. The tables below present information by operating segment (*in thousands*):

	United			Unallocated	
13 Weeks Ended	States	International	Global CPG	Corporate <sup>(1)</sup>	Total
<i>July 1, 2007</i>					
Net Revenues:					
Company-operated retail	\$1,646,234	\$364,538	\$	\$	\$2,010,772
Specialty:					
Licensing	110,130	57,653	87,121		254,904
Foodservice and other	83,806	9,763			93,569
Total specialty	193,936	67,416	87,121		348,473
Total net revenues	1,840,170	431,954	87,121		2,359,245
Earnings/(loss) before income taxes	254,037	35,534	41,937	(88,535)	242,973
Depreciation and amortization	89,134	21,287	18	8,970	119,409
Income from equity investees		11,909	12,594		24,503
Net impairment and disposition losses	1,250	6,310		105	7,665
<i>July 2, 2006</i>					
Net Revenues:					
Company-operated retail	\$1,380,901	\$280,076	\$	\$	\$1,660,977
Specialty:					
Licensing	96,266	49,665	70,336		216,267
Foodservice and other	78,981	7,448			86,429
Total specialty	175,247	57,113	70,336		302,696
Total net revenues	1,556,148	337,189	70,336		1,963,673
Earnings/(loss) before income taxes	226,190	29,240	39,101	(74,930)	219,601
Depreciation and amortization	72,238	17,260	26	9,015	98,539
Income from equity investees		10,109	15,557		25,666
Net impairment and disposition losses	1,830	1,027		7	2,864

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39 Weeks Ended	United States	International	Global CPG	Unallocated Corporate <sup>(1)</sup>	Total
<i>July 1, 2007</i>					
Net Revenues:					
Company-operated retail	\$4,901,886	\$1,038,402	\$	\$	\$5,940,288
Specialty:					
Licensing	328,229	158,722	256,682		743,633
Foodservice and other	259,384	27,257			286,641
Total specialty	587,613	185,979	256,682		1,030,274
Total net revenues	5,489,499	1,224,381	256,682		6,970,562
Earnings/(loss) before income taxes	850,729	91,356	121,197	(253,764)	809,518
Depreciation and amortization	254,926	62,401	61	25,602	342,990
Income from equity investees		32,849	36,668		69,517
Net impairment and disposition losses	6,490	13,522	2	1,151	21,165
<i>July 2, 2006</i>					
Net Revenues:					
Company-operated retail	\$4,103,151	\$ 785,653	\$	\$	\$4,888,804
Specialty:					
Licensing	274,000	134,699	229,072		637,771
Foodservice and other	235,936	21,076			257,012
Total specialty	509,936	155,775	229,072		894,783
Total net revenues	4,613,087	941,428	229,072		5,783,587
Earnings/(loss) before income taxes	756,111	82,638	119,706	(253,702)	704,753
Depreciation and amortization	209,456	48,555	87	26,237	284,335
Income from equity investees	151	27,012	38,208		65,371
Net impairment and disposition losses/(gains)	5,742	6,283		(8)	12,017

(1) Unallocated corporate includes certain general and administrative expenses, related depreciation and amortization expenses and amounts included in Net interest and other (expense)/income on the consolidated statements of earnings.

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The table below represents information by geographic area (*in thousands*):

	13 Weeks Ended		39 Weeks Ended	
	July 1, 2007	July 2, 2006	July 1, 2007	July 2, 2006
Net revenues from external customers:				
United States	\$1,916,869	\$1,625,606	\$5,722,527	\$4,837,177
Foreign countries	442,376	338,067	1,248,035	946,410
Total	\$2,359,245	\$1,963,673	\$6,970,562	\$5,783,587

No customer accounts for 10% or more of the Company's revenues. Revenues from foreign countries are based on the geographic location of the customers and consist primarily of revenues from the United Kingdom and Canada, which together account for approximately 71% of foreign net revenues.

## **Note 13: Subsequent Event**

On August 7, 2007, the Company entered into a credit agreement with the Bank of America, N.A. as administrative agent, Citibank, N.A. and Goldman Sachs Bank USA, as syndication agents, and other lenders. The

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credit agreement provides for a \$400 million unsecured, revolving 364-day credit facility with a maturity date of August 5, 2008. The Company intends to use the 364-day credit facility for general corporate purposes, which may include share repurchases. This 364-day credit facility is in addition to the Company's existing \$1.0 billion unsecured five-year credit facility, which matures in August 2011.

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**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**  
**CAUTIONARY STATEMENT PURSUANT TO THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995**

*Certain statements herein, including anticipated store openings, trends in or expectations regarding Starbucks Corporation's comparable store sales and revenue growth, effective tax rate, cash flow requirements and capital expenditures all constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such statements are based on currently available operating, financial and competitive information and are subject to various risks and uncertainties. Actual future results and trends may differ materially depending on a variety of factors, including, but not limited to, coffee, dairy and other raw materials prices and availability, successful execution of internal performance and expansion plans, fluctuations in United States and international economies and currencies, ramifications from the war on terrorism, or other international events or developments, the impact of competitors' initiatives, the effect of legal proceedings, and other risks detailed herein and in Starbucks Corporation's other filings with the SEC, including the Item 1A. Risks Factors section of the 10-K.*

*A forward-looking statement is neither a prediction nor a guarantee of future events or circumstances, and those future events or circumstances may not occur. Users should not place undue reliance on the forward-looking statements, which speak only as of the date of this report. The Company is under no obligation to update or alter any forward-looking statements, whether as a result of new information, future events or otherwise.*

This information should be read in conjunction with the consolidated financial statements and the notes included in Item 1 of Part I of this Quarterly Report and the audited consolidated financial statements and notes, and Management's Discussion and Analysis of Financial Condition and Results of Operations, contained in the 10-K.

**General**

Starbucks Corporation's fiscal year ends on the Sunday closest to September 30. Fiscal year 2006 had 52 weeks and the fiscal year ending on September 30, 2007 will also include 52 weeks. All references to store counts, including data for new store openings, are reported net of related store closures.

**Management Overview**

During both the 13 and 39 week periods ended July 1, 2007, the Company's continued focus on execution in all areas of its business, from U.S. and International Company-operated retail operations to the Company's specialty operations, delivered solid financial performance despite a challenging environment which included significantly higher dairy costs in the U.S. business. Management believes that its ability to achieve the balance between growing the core business and building the foundation for future growth is the key to increasing long-term shareholder value. Starbucks quarterly and year-to-date fiscal 2007 performance reflects the Company's ongoing commitment to achieving this balance.

The primary driver of the Company's revenue growth continues to be the opening of new retail stores, both Company-operated and licensed, in pursuit of the Company's objective to establish Starbucks as one of the most recognized and respected brands in the world. Starbucks opened 1,956 new stores in the first three quarters of fiscal 2007 and plans to open at least 2,400 net new stores in fiscal 2007.

In addition to opening new retail stores, Starbucks works to increase revenues generated at new and existing Company-operated stores by attracting new customers and increasing the frequency of visits by current customers. The strategy is to increase comparable store sales by continuously improving the level of customer service, introducing innovative products and improving speed of service through training, technology and process improvement.



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Global comparable store sales for Company-operated markets increased by 4% for the 13-week period ended July 1, 2007, and increased 5% over the first three quarters of fiscal 2007. Comparable store sales growth for fiscal 2007 is expected to be in the target range of 3% to 7%.

In licensed retail operations, Starbucks shares operating and store development experience to help licensees improve the profitability of existing stores and build new stores. Internationally, the Company's strategy is to selectively increase its equity stake in licensed international operations as these markets develop. In the first quarter of fiscal 2007, the Company purchased a 90% stake in its previously-licensed operations in Beijing and Tianjin, China. Starbucks has three reportable segments: United States, International and the Global Consumer Products Group (CPG).

The United States and International segments both include Company-operated retail stores, licensed retail stores and foodservice operations. The United States segment has been operating significantly longer than the International segment and has developed deeper awareness of, and attachment to, the Starbucks brand and stores among its customer base. As a result, the United States segment has significantly more stores, higher average sales per store, and higher total revenues than the International segment. Further, certain market costs, particularly occupancy costs, are lower in the United States segment compared to the markets of the International segment. As a result of the relative strength of the brand in the United States segment, the number of stores, the higher unit volumes, and the lower market costs, the United States segment has a higher operating margin than the less-developed International segment. The Company believes it has achieved an appropriate level of annual new store openings domestically, for the near term. The current pace of openings of approximately 1,700 per year in the U.S. will allow the Company to continue to grow revenues while limiting the degree of cannibalization of existing store sales caused by new stores. Management continues to believe in and intends to capture the substantial opportunity to grow in the U.S. market.

The Company's International store base continues to increase rapidly and Starbucks is achieving a growing contribution from established international markets while at the same time investing in emerging markets, such as China, Brazil and Russia. The Company's newer international markets require a more extensive support organization, relative to the current levels of revenue and operating income. The Company's ongoing investments in International infrastructure can be expected to cause variability in quarterly operating margins for the International segment. The CPG segment includes the Company's grocery and warehouse club business as well as branded products operations worldwide. The CPG segment operates primarily through joint ventures and licensing arrangements with large consumer products business partners, most significantly The North American Coffee Partnership with the Pepsi-Cola Company for distribution of ready-to-drink beverages, and with Kraft Foods Inc. for distribution of packaged coffees and teas. This operating model allows the CPG segment to leverage the business partners' existing infrastructures and to extend the Starbucks brand in an efficient way. Most of the customer revenues from the ready-to-drink and packaged coffee channels are recognized by the joint venture or licensed business partner, not by the CPG segment, and the results of the Company's joint ventures are included on a net basis in Income from equity investees on the consolidated statements of earnings. As a result, the CPG segment reflects relatively lower revenues, a modest cost structure, and a resulting higher operating margin, compared to the Company's other two reporting segments, which consist primarily of retail stores.

The 20% increase in the Company's consolidated total net revenues for the 13-week period ended July 1, 2007, compared to the same period of fiscal 2006, was driven by the combination of more retail stores, comparable store sales growth of 4% and growth in other business channels. The Company expects consolidated total net revenue growth of approximately 20% in fiscal 2007.

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Operating income as a percentage of total net revenues was 10.4% for the 13 weeks ended July 1, 2007 compared to 10.9% for the corresponding period ended July 2, 2006, due to higher cost of sales including occupancy costs partially offset by leveraging general and administrative expenses, store operating expenses, and other operating expenses as a percentage of total net revenues. Net earnings increased by 9% in the 13-week period ended July 1, 2007, compared to the same period in fiscal 2006.

**Table of Contents****Results of Operations for the 13 Weeks Ended July 1, 2007 and July 2, 2006****CONSOLIDATED RESULTS**

The following table presents the consolidated statements of earnings as well as the percentage relationship to total net revenues of items included in the Company's consolidated statements of earnings (*amounts in thousands*):

	13 Weeks Ended			13 Weeks Ended	
	July 1, 2007	July 2, 2006	% Change	July 1, 2007	July 2, 2006
	As a % of total net revenues				
STATEMENTS OF EARNINGS DATA					
Net revenues:					
Company-operated retail	\$ 2,010,772	\$ 1,660,977	21.1%	85.2%	84.6%
Specialty:					
Licensing	254,904	216,267	17.9	10.8	11.0
Foodservice and other	93,569	86,429	8.3	4.0	4.4
Total specialty	348,473	302,696	15.1	14.8	15.4
Total net revenues	2,359,245	1,963,673	20.1	100.0	100.0
Cost of sales including occupancy costs	1,003,881	804,889		42.6	41.0
Store operating expenses <sup>(1)</sup>	819,212	686,602		34.7	35.0
Other operating expenses <sup>(2)</sup>	76,507	69,478		3.2	3.5
Depreciation and amortization expenses	119,409	98,539		5.1	5.0
General and administrative expenses	119,525	115,258		5.1	5.9
Subtotal operating expenses	2,138,534	1,774,766	20.5	90.7	90.4
Income from equity investees	24,503	25,666		1.1	1.3
Operating income	245,214	214,573	14.3	10.4	10.9
Net interest and other (expense)/income	(2,241)	5,028		(0.1)	0.3
Earnings before income taxes	242,973	219,601	10.6	10.3	11.2
Income taxes	84,630	74,103		3.6	3.8
Net earnings	\$ 158,343	\$ 145,498	8.8%	6.7%	7.4%

<sup>(1)</sup> As a percentage of related Company-operated retail revenues, store operating

expenses were  
40.7% for the  
13 weeks ended  
July 1, 2007, and  
41.3% for the  
13 weeks ended  
July 2, 2006.

- (2) As a percentage of  
related total  
specialty revenues,  
other operating  
expenses were  
22.0% for the  
13 weeks ended  
July 1, 2007, and  
23.0% for the  
13 weeks ended  
July 2, 2006.

Net revenues for the 13 weeks ended July 1, 2007, increased 20% to \$2.4 billion from \$2.0 billion for the corresponding period of fiscal 2006, driven by increases in both Company-operated retail revenues and specialty operations. Net revenues are expected to grow approximately 20% in fiscal 2007 compared to fiscal 2006. During the 13-week period ended July 1, 2007, Starbucks derived 85% of total net revenues from its Company-operated retail stores. Company-operated retail revenues increased 21% to \$2.0 billion for the 13 weeks ended July 1, 2007, from \$1.7 billion for the same period in fiscal 2006. The increase was primarily attributable to the opening of 1,369 new Company-operated retail stores in the last 12 months and comparable store sales growth of 4% for the 13 weeks ended July 1, 2007. The increase in comparable store sales was due to a 3% increase in the average value per transaction and a 1% increase in the number of customer transactions.

The Company derived the remaining 15% of total net revenues from channels outside the Company-operated retail stores, collectively known as specialty operations. Specialty revenues, which include licensing revenues and

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foodservice and other revenues, increased 15% to \$348 million for the 13 weeks ended July 1, 2007, from \$303 million for the corresponding period of fiscal 2006.

Licensing revenues, which are derived from retail store licensing arrangements as well as grocery, warehouse club and certain other branded-product operations, increased 18% to \$255 million for the 13 weeks ended July 1, 2007, from \$216 million for the corresponding period of fiscal 2006. The increase was primarily due to higher product sales and royalty revenues from the opening of 1,243 new licensed retail stores in the last 12 months and a 24% increase in licensing revenues from the Company's Global Consumer Products business.

Foodservice and other revenues increased 8% to \$94 million for the 13 weeks ended July 1, 2007, from \$86 million for the corresponding period of fiscal 2006. The increase was primarily attributable to growth in new and existing accounts in the U.S. foodservice business.

Cost of sales including occupancy costs increased to 42.6% of total net revenues for the 13 weeks ended July 1, 2007, compared to 41.0% for the corresponding period of fiscal 2006. The increase was primarily due to a shift in sales mix to higher cost products, the rise in dairy costs, and higher rent expense.

Store operating expenses as a percentage of Company-operated retail revenues decreased to 40.7% for the 13 weeks ended July 1, 2007, from 41.3% for the corresponding period of fiscal 2006, primarily due to controlled discretionary spending.

Other operating expenses (expenses associated with the Company's specialty operations) decreased to 22.0% of total specialty revenues for the 13 weeks ended July 1, 2007, compared to 23.0% in the corresponding period of fiscal 2006. The decline resulted primarily from lower marketing and advertising costs in fiscal 2007.

Depreciation and amortization expenses increased to \$119 million for the 13 weeks ended July 1, 2007, compared to \$99 million for the corresponding period of fiscal 2006. The increase was primarily due to the opening of 1,369 new Company-operated retail stores in the last 12 months. As a percentage of total net revenues, depreciation and amortization expenses increased slightly to 5.1% for the 13 weeks ended July 1, 2007, from 5.0% for the corresponding period in fiscal 2006.

General and administrative expenses increased to \$120 million for the 13 weeks ended July 1, 2007, compared to \$115 million for the corresponding period of fiscal 2006. The increase was primarily due to higher payroll-related expenditures in support of continued global growth. As a percentage of total net revenues, general and administrative expenses decreased to 5.1% for the 13 weeks ended July 1, 2007, from 5.9% for the corresponding period of fiscal 2006.

Income from equity investees decreased 5% to \$25 million for the 13 weeks ended July 1, 2007, compared to \$26 million for the corresponding period of fiscal 2006, primarily due to lower sales volumes for The North American Coffee Partnership, which produces ready-to-drink beverages, including Starbucks bottled Frappuccino® coffee drinks and Starbucks DoubleShot®.

Operating income increased 14% to \$245 million for the 13 weeks ended July 1, 2007, compared to \$215 million for the corresponding period of fiscal 2006. Operating margin decreased to 10.4% of total net revenues for the 13 weeks ended July 1, 2007, from 10.9% for the corresponding period of fiscal 2006. Higher cost of sales including occupancy costs were offset, in part, by leveraging general and administrative expenses, store operating expenses, and other operating expenses.

Net interest and other was an expense of \$2.2 million for the 13 weeks ended July 1, 2007, compared to income of \$5.0 million for the corresponding period of fiscal 2006, primarily due to a higher level of borrowings outstanding.

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Income taxes for the 13 weeks ended July 1, 2007, resulted in an effective tax rate of 34.8%, compared to 33.7% for the corresponding period of fiscal 2006. The effective tax rate is expected to be approximately 37% for the full fiscal year of 2007.

Net earnings for the 13 weeks ended July 1, 2007, increased 9% to \$158 million from \$145 million for the corresponding period in fiscal 2006. Diluted earnings per share increased to \$0.21 for the 13 weeks ended July 1, 2007, compared to \$0.18 per share for the comparable period in fiscal 2006.

**SEGMENT RESULTS**

Segment information is prepared on the basis that the Company's management reviews financial information for operational decision-making purposes. The following tables summarize the Company's results of operations by segment (*in thousands*):

**United States**

	July 1, 2007	13 Weeks Ended July 2, 2006	% Change	13 Weeks Ended July 1, 2007 As a % of U.S. total net revenues	July 2, 2006
Net revenues:					
Company-operated retail	\$1,646,234	\$1,380,901	19.2%	89.5%	88.7%
Specialty:					
Licensing	110,130	96,266	14.4	6.0	6.2
Foodservice and other	83,806	78,981	6.1	4.5	5.1
Total specialty	193,936	175,247	10.7	10.5	11.3
Total net revenues	1,840,170	1,556,148	18.3	100.0	100.0
Cost of sales including occupancy costs	742,232	600,597		40.3	38.6
Store operating expenses <sup>(1)</sup>	682,595	582,505		37.1	37.4
Other operating expenses <sup>(2)</sup>	51,785	50,964		2.8	3.3
Depreciation and amortization expenses	89,134	72,238		4.8	4.6
General and administrative expenses	21,214	24,510		1.2	1.6
Subtotal operating expenses	1,586,960	1,330,814	19.2	86.2	85.5
Income from equity investees					