# STARBUCKS CORP

## FORM 10-K
(Annual Report)

### Filed 12/23/1997 For Period Ending 9/28/1997

| | |
|---|---|
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| Industry | Restaurants |
| Sector | Services |
| Fiscal Year | 09/28 |

# SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

# FORM 10-K

**[ x ] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**FOR THE FISCAL YEAR ENDED SEPTEMBER 28, 1997**

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) | (I.R.S. Employer Identification Number) |

**2401 UTAH AVENUE SOUTH, SEATTLE, WASHINGTON 98134**
(Address of Principal Executive Offices) (Zip Code)

Registrant's Telephone Number, including Area Code: (206) 447-1575

Securities Registered Pursuant to Section 12(b) of the Act: NONE

**Securities Registered Pursuant to Section 12(g) of the Act:**

**COMMON STOCK, NO PAR VALUE**

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation of S-K is not contained herein, and will not be contained, to the best of the Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form l0-K. [ ]

The aggregate market value of the voting stock held by non-affiliates of the Registrant, based upon the closing sale price of the Registrants Common Stock on December 1, 1997, as reported on the National Market tier of The Nasdaq Stock Market, Inc. was $3,126,611,409.

As of December l, 1997, there were 86,263,599 shares of the Registrant's Common Stock outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Registrants Annual Report to Shareholders for the fiscal year ended September 28, 1997 have been incorporated by reference into Parts II and IV of this Annual Report on Form 10-K. Portions of the definitive Proxy Statement for the Registrant's Annual Meeting of Shareholders to be held on February 5, 1998 have been incorporated by reference into Part III of this Annual Report on Form 10-K.

Cautionary Statement pursuant to the Private Securities Litigation Reform Act of 1995

Certain statements set forth in or incorporated by reference into this Annual Report on Form 10-K, including anticipated store openings, planned capital expenditures and trends in or expectations regarding the Company's operations, 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 and other raw materials prices and availability, successful execution of internal performance and expansion plans, the impact of competition, the availability of financing, the volatility of interest rates and securities prices, the effect of legal proceedings and other risks detailed herein.

# PART I

## ITEM 1. BUSINESS

General. Starbucks Corporation and its subsidiaries (collectively "Starbucks" or the "Company") purchases and roasts high-quality whole bean coffees and sells them, along with fresh, rich-brewed coffees, Italian-style espresso beverages, a variety of pastries and confections and coffee-related accessories and equipment, primarily through its Company-operated retail stores. In addition to sales through its Company-operated retail stores, Starbucks sells primarily whole bean coffees through a specialty sales group and a direct response business. Starbucks, through its joint venture partnerships, also produces and sells bottled Frappuccino(TM) coffee drink and a line of premium coffee ice creams. The Company's objective is to establish Starbucks as the most recognized and respected brand of coffee in the world. To achieve this goal, the Company plans to continue to rapidly expand its retail operations, grow its specialty sales and direct response businesses, and selectively pursue other opportunities to leverage the Starbucks brand through the introduction of new products and the development of new distribution channels.

Starbucks is committed to selling only the finest whole bean coffees and coffee beverages. To ensure compliance with its rigorous coffee standards, Starbucks is vertically integrated, with the Company controlling its coffee purchasing, roasting and distribution through its retail stores. The Company purchases green coffee beans for its many blends and varietals from coffee-producing regions around the world and custom roasts them to its exacting standards. To allow customers to extend the Starbucks experience to their homes, the Company continually works with leading manufacturers to develop innovative and often proprietary coffee-making equipment and accessories.

Company-Operated Retail Stores. 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 superior customer service, thereby building a high degree of customer loyalty. Starbucks strategy for expanding its retail business is to increase its market share in existing markets and to open stores in new markets where the opportunity exists to become the leading specialty coffee retailer. During the fiscal year ended September 28, 1997 ("fiscal 1997"), the Company entered 18 new markets in continental North America, including the major markets of Phoenix, AZ, Detroit, MI and Miami, FL. As of September 28, 1997, Starbucks had 1,270 Company-operated stores in 28 states, the District of Columbia and three Canadian provinces. Company-operated retail stores accounted for approximately 86% of net revenues during fiscal 1997. The Company and its licensees intend to open 350 new stores in continental North America during the fiscal year ended September 27, 1998 ("fiscal 1998") and to have 2,000 locations by the year 2000. The Company intends to use cash flow from operations to finance such growth, supplemented by additional debt or equity financing, if necessary.

Starbucks stores are typically clustered in high-traffic, high-visibility locations. Because the Company can vary the size and format of its stores, Starbucks stores are located in a variety of settings, including downtown and suburban retail centers, office buildings, supermarket foyers and on university campuses. While the Company selectively locates stores in suburban malls, it focuses on stores that are convenient for pedestrian street traffic.

All Starbucks stores offer a choice of regular or decaffeinated coffee beverages including a "coffee of the day," a broad selection of Italian-style espresso beverages and distinctively packaged, roasted whole bean coffees.

Starbucks stores also offer a selection of fresh pastries and other food items, sodas, juices, tea, and coffee-making equipment and accessories. Each Starbucks store varies its product mix depending upon the size of the store and its location. Larger stores carry a broad selection of the Company's whole bean coffees in various sizes and types of packaging, as well as an assortment of coffee and espresso-making equipment and accessories such as coffee grinders, drip coffee makers, espresso machines, coffee filters, storage containers, travel tumblers and mugs. Smaller Starbucks stores and kiosks typically sell a full line of coffee beverages, a more limited selection of whole bean coffees and a few accessories such as travel tumblers and logo mugs. During fiscal 1997, the Company's retail sales mix by product type was approximately 63% coffee beverages, 14% whole bean coffees, 16% food items, and 7% coffee-making equipment and accessories.

Specialty Sales. Starbucks specialty sales operations strive to develop the Starbucks brand outside the retail store environment. The Company's specialty sales operations reach customers as they shop, travel, work and dine through relationships with retailers, airlines, hotels and office supply companies, and numerous fine dining and food service establishments. Through joint ventures, the Company has developed and introduced new products to customers of supermarkets, convenience and drug stores. The Company's specialty sales business also reaches customers through its international operations and new supermarket initiative. During fiscal 1997, specialty sales revenues (which include royalties and fees from licensees as well as sales of products to licensees and joint ventures) accounted for approximately 12% of the Company's net revenues.

Licensees and Joint Ventures. Although the Company does not generally relinquish operational control of its stores in North America, in situations in which a master concessionaire controls desirable retail space, the Company may consider licensing its operations. As part of such arrangements, Starbucks receives license fees and royalties and sells coffee for resale in the licensed locations. Employees working in the licensed locations must follow Starbucks detailed store-operating procedures and attend the same core training classes given to Starbucks store managers and employees. As of September 28, 1997, the Company had 94 licensee-operated stores in continental North America.

In addition to its relationships with licensees, the Company has entered into joint ventures with the Pepsi-Cola Company, a division of PepsiCo, Inc. ("Pepsi"), and Dreyer's Grand Ice Cream, Inc. ("Dreyer's"). The joint venture with Pepsi, The North American Coffee Partnership, was formed in fiscal 1994 to develop and distribute ready-to-drink coffee-based products. In May 1996, The North American Coffee Partnership introduced bottled Frappuccino coffee drink in selected supermarkets and other retail points of distribution throughout the west coast of the United States. In mid-1997, the joint venture began to distribute Frappuccino to additional supermarkets, convenience and drug stores on the west coast as well as key cities in the midwest and northeast United States. The Company's joint venture with Dreyer's was formed in early fiscal 1996 to develop and distribute Starbucks premium coffee ice creams. During fiscal 1997, the Company expanded the product line produced and distributed through the joint venture from six flavors of ice cream to eight flavors of ice cream and two novelty products, including two low-fat ice creams and a low-fat blended coffee bar. (See Note 5 to the Company's consolidated financial statements, "Joint Ventures and Other Investments," incorporated by reference to the Company's 1997 Annual Report to Shareholders in Item 8 of this Form 10-K.)

International. Starbucks considers locations outside of continental North America to be part of its international operations. In fiscal 1995 and 1996, the Company entered into agreements to develop Starbucks stores in Japan, Hawaii and Singapore. By the end of fiscal 1997, ten Starbucks stores were operating in Japan, four were operating in Hawaii and three were operating in Singapore. During fiscal 1997, the Company continued its international expansion by entering into an agreement with Rustan Coffee Corporation, a part of the Rustan Group, to develop Starbucks retail business in the Philippines. The first store opened in December 1997 and two additional stores are expected to open by the end of fiscal 1998. The Company also continued its expansion into the Pacific Rim by entering into agreements with President Chain Store and ESCO (a subsidiary of Shinsegae Department Store Co., Ltd.) to develop Starbucks retail stores in Taiwan and the Republic of Korea, respectively.

Supermarket Test. Late in fiscal 1997, Starbucks initiated a major supermarket test of its whole bean and ground coffees in the greater Chicago, Illinois area. The Chicago test follows a more limited test conducted in early 1997 in Portland, Oregon and encompasses approximately 500 grocery stores. The Company is offering five new caffeinated blends and one new decaffeinated blend in both whole bean and ground form. The packaging and merchandising of the new blends has been designed to be distinctive and eye-catching on the supermarket aisle. The

Company is conducting the test to gauge both consumer response and the effects of potential cannibalization of its retail business and is planning to extend the supermarket test to an additional market by mid-1998.

Direct Response. The Company's direct response operations ensure that fresh Starbucks coffee and products are conveniently available via mail order and on-line. Starbucks publishes and distributes a mail order catalog that offers its coffees, certain food items and select coffee-making equipment and accessories. The Company also operates a standing order coffee delivery service and an electronic store on America Online that allows customers to order their favorite coffee and products on-line. Starbucks ships products to customers located in all 50 states and in many foreign countries. Direct response sales accounted for approximately 2% of the Company's net revenues in fiscal 1997. Management believes that the Company's direct response operations support its retail store expansion into new markets and reinforce brand recognition in existing markets.

Product Supply. Coffee is the world's second largest traded commodity and its supply and price 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. Supply and price can be affected by multiple factors in the producing countries, including weather, political and economic conditions. In addition, green coffee prices have been affected in the past, and may be affected in the future, by the actions of certain organizations and associations, such as the International Coffee Organization and the Association of Coffee Producing Countries, which have historically attempted to influence commodity prices of green coffee through agreements establishing export quotas or restricting coffee supplies worldwide.

The Company depends upon its direct contacts with exporters in countries of origin and outside brokers for its supply of green coffee. To secure an adequate supply and to fix costs for future periods, the Company routinely enters into fixed price purchase commitments for future deliveries of coffee with such exporters and brokers. As of September 28, 1997, the Company had approximately $54 million in fixed price purchase commitments which, together with existing inventory, is expected to provide an adequate supply of green coffee well into fiscal 1998. The Company believes, based on relationships established with its suppliers in the past, that the risk of non-delivery on such purchase commitments is remote. In addition, the Company may from time to time purchase and sell coffee futures contracts to provide additional price protection. There can be no assurance that these activities will successfully protect the Company against the risks of higher coffee prices or that such activities will not result in the Company having to pay substantially more for its coffee supply than it would have been required to pay absent such activities. The Company did not purchase or sell any futures contracts in fiscal 1997.

Products other than whole bean coffees and coffee beverages sold in Starbucks retail stores are obtained through a number of different channels. Specialty foods, such as fresh pastries and lunch items, are generally purchased from local sources based on quality and price. Coffee-making equipment, such as drip and french press coffee makers, espresso machines and coffee grinders, are generally purchased directly from their manufacturers for resale. Coffee-related accessories, including items bearing the Company's logos and trademarks, are produced and distributed through contracts with a number of different vendors.

Competition. The Company's whole bean coffees compete directly against specialty coffees sold at retail through supermarkets, specialty retailers, and a growing number of specialty coffee stores. The Company's coffee beverages compete directly against all restaurant and beverage outlets that serve coffee and a growing number of espresso stands, carts, and stores. Both the Company's whole bean coffees and its coffee beverages compete indirectly against all other coffees on the market. The Company believes that its customers choose among retailers primarily on the basis of product quality, service and convenience, and, to a lesser extent, on price.

Management believes that supermarkets pose the greatest competitive challenge in the whole bean coffee market, in part because supermarkets offer customers the convenience of not having to make a separate trip to a specialty coffee store. A number of nationwide coffee manufacturers, such as Kraft Foods, Inc., The Procter & Gamble Company, and Nestle USA, Inc., are distributing premium coffee products in supermarkets that may serve as substitutes for the Company's coffees. Regional specialty coffee companies also sell whole bean coffees in supermarkets.

In addition to the competition generated by supermarket sales of coffee, Starbucks competes for whole bean coffee sales with franchise operators and independent specialty coffee stores. In virtually every major metropolitan area where Starbucks operates and expects to expand, there are local or regional competitors with substantial market presence in the specialty coffee business.

The Company's primary competitors for coffee beverage sales are restaurants, shops, and street carts. In almost all markets in which the Company does business there has been a significant increase in competition in the specialty coffee beverage business and management expects this trend to continue. Although competition in the beverage market is currently fragmented, a major competitor with substantially greater financial, marketing and operating resources than the Company could enter this market at any time and compete directly against the Company.

In addition to the competition for whole bean coffee and coffee beverage retail sales, the Company faces intense competition from both restaurants and other specialty retailers for suitable sites for new stores and qualified personnel to operate both new and existing stores. There can be no assurance that Starbucks will be able to continue to secure adequate sites at acceptable rent levels or that the Company will be able to attract a sufficient number of qualified workers. Starbucks specialty sales and direct response businesses also face significant competition from established wholesale and mail order suppliers, some of whom have greater financial and marketing resources than the Company.

Patents, Trademarks and Copyrights. The Company owns and/or has applied to register numerous trademarks and service marks in the United States, Canada and in more than eighty additional countries throughout the world. Rights to the trademarks and service marks in the United States are held by Starbucks U.S. Brands Corporation, a wholly-owned subsidiary of the Company, and are used by the Company under license. One of the Company's subsidiaries, The Coffee Connection, Inc. ("The Coffee Connection"), also owns a number of trademarks and service marks in the United States, Canada and elsewhere, including registrations for "The Coffee Connection" name and logo. Some of the Company's trademarks, including "Starbucks," the Starbucks logo and "Frappuccino," are of material importance to the Company. Trademarks are generally valid as long as they are in use and/or their registrations are properly maintained, and they have not been found to have become generic. Trademark registrations can generally be renewed indefinitely so long as the marks are in use.

The Company also owns numerous copyrights for its product packaging, promotional materials, in-store graphics and training materials, among other things. The Company also holds patents on certain products and systems. While valuable, individual copyrights and patents currently held by the Company are not viewed as material to the Company's business.

Research and Development. The Company's Research and Development department is comprised of chemists, engineers, food scientists and technicians responsible for the formulation and technical development of new food, beverage and equipment products. The department has played a major role in the development of bottled Frappuccino and coffee ice cream products, as well as the development of a home espresso machine with a new portafilter system that accommodates both ground coffee and espresso filter packs ("pods"). The Company spent approximately $2.6 million during fiscal 1997 on technical research and development activities, in addition to customary product testing and development in all areas of the Company's business.

Seasonality and Quarterly Results. The Company's business is subject to seasonal fluctuations. Significant portions of the Company's net revenues and profits are realized during the first quarter of the Company's fiscal year that includes the December holiday season. In addition, quarterly results are affected by the timing of the opening of new stores, and the Company's rapid growth may conceal the impact of other seasonal influences. Because of the seasonality of the Company's business, results for any quarter are not necessarily indicative of the results that may be achieved for the full fiscal year.

Employees. As of September 28, 1997, the Company employed approximately 25,000 individuals, approximately 22,000 in retail stores and regional offices and the remainder in the Company's administrative, sales, real estate, direct response, roasting, and warehousing operations. At fiscal year end, ten of the Company's stores (out of a total of 1,270 Company-operated stores in continental North America) were unionized. In July 1997, Starbucks and the Canadian Auto Workers Union entered into a labor agreement governing such stores that extends for two years. The Company believes that its current relations with its employees are excellent.

**ITEM 2. PROPERTIES**

Starbucks currently operates three roasting and distribution facilities
- two in the Seattle, Washington area, and one in East Manchester Township, York County, Pennsylvania. In the Seattle area, the Company leases approximately 92,000 square feet in one building pursuant to a lease extendable through 2009 (the "Seattle Plant"), owns an additional roasting plant and distribution facility of approximately 305,000 square feet located in Kent, Washington, and leases a warehouse facility of approximately 156,000 square feet in Kent, Washington. The Company has a lease agreement with York County Industrial Development Corporation for a roasting and distribution facility (the "York Plant"), providing for approximately 365,000 square feet initially. The lease has a 15-year term and the Company has an option to purchase the land and building within five years of the date of occupancy. Such option to purchase also provides that the Company may purchase, within seven years of occupancy, additional land adjacent to the York Plant that would expand it to 1,000,000 square feet. The Company is party to a letter of intent and a commitment letter which provide that in the event that the Company exercises its option to purchase the York Plant, the Company will have the right to assume loans incurred in connection with its development. The Company has determined that it no longer needs its much-smaller roasting plant located in Boston (which formerly operated as the roasting plant for The Coffee Connection) and has sublet it to a third party. The lease on this facility runs through 2002.

The Company also leases approximately 350,000 square feet of a building located in Seattle, Washington for administrative offices and has options to lease approximately 250,000 additional square feet in such building. The Company owns 2.36 acres (102,800 square feet) of undeveloped land near its administrative offices and adjacent to the Seattle Plant, which is currently used for parking.

As of September 28, 1997, Starbucks operated a total of 1,270 retail stores. All Starbucks stores are located in leased premises. The Company also leases space in approximately 50 additional locations for regional, district and other administrative offices, training facilities and storage, not including spaces within retail stores used for such purposes and certain seasonal retail storage locations.

**ITEM 3. LEGAL PROCEEDINGS**

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

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.**

No matters were submitted to a vote of security holders during the fourth quarter of fiscal year 1997.

## PART II

### ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

The information required by this item is incorporated herein by reference to the section entitled "Shareholder Information" in the Company's 1997 Annual Report to Shareholders.

### ITEM 6. SELECTED FINANCIAL DATA

The information required by this item is incorporated herein by reference to the section entitled "Selected Financial Data" in the Company's 1997 Annual Report to Shareholders.

### ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The information required by this item is incorporated herein by reference to the section entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations" in the Company's 1997 Annual Report to Shareholders.

### ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The information required by this item is incorporated herein by reference to the section entitled "Financial Risk Management" in the Company's 1997 Annual Report to Shareholders.

### ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The information required by this item is incorporated herein by reference to the Consolidated Financial Statements and the notes thereto in the Company's 1997 Annual Report to Shareholders.

### ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURES

None.

**PART III**

## ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

Information concerning the directors of the Company and compliance with Section 16(a) of the Securities Exchange Act of 1934, as amended, is incorporated herein by reference to the sections entitled " Proposal 1 - Election of Directors" and "Executive Compensation Section 16(a) Beneficial Ownership Reporting Compliance" in the Company's definitive Proxy Statement for the Annual Meeting of Shareholders to be held on February 5, 1998 (the "Proxy Statement"). The Company intends to file the Proxy Statement within 120 days after the end of its fiscal year.

The executive officers of the Company, each of whom serves a one-year term and until his or her successor is elected and qualified, are as follows:

| Name | Age | Position | Executive Officer Since |
|---|---|---|---|
| Howard Schultz | 44 | chairman of the board and chief executive officer | 1985 |
| Orin Smith | 55 | director, president and chief operating officer | 1990 |
| Howard Behar | 53 | director and president, Starbucks Coffee International, Inc. | 1989 |
| John Richards | 49 | president, Retail, North America | 1997 |
| Michael Casey | 52 | executive vice president, chief financial officer and chief administrative officer | 1995 |
| E. R. (Ted) Garcia | 50 | executive vice president, Supply Chain Operations | 1995 |
| Deidra Wager | 42 | executive vice president, Retail Marketing and Operations Services | 1993 |
| James Alling | 36 | senior vice president, Grocery | 1997 |
| Scott Bedbury | 40 | senior vice president, Brand Development | 1995 |
| Bruce Craig | 55 | senior vice president, Retail Field Operations | 1997 |
| Vincent Eades | 38 | senior vice president, Specialty Sales and Marketing | 1995 |
| Sharon E. Elliott | 46 | senior vice president, Human Resources | 1994 |
| Deborah Gillotti | 40 | senior vice president and chief information officer | 1997 |
| Wanda Herndon | 45 | senior vice president, Communications and Public Affairs | 1996 |
| Shelley B. Lanza | 41 | senior vice president, Law and Corporate Affairs and general counsel | 1995 |
| Judy Meleliat | 40 | senior vice president, Marketing | 1997 |
| David M. Olsen | 51 | senior vice president | 1991 |
| Arthur I. Rubinfeld | 44 | senior vice president, Store Development | 1992 |
| Don Valencia | 45 | senior vice president, Research and Development | 1997 |
| Mary Williams | 48 | senior vice president, Coffee | 1997 |

HOWARD SCHULTZ is the founder of the Company and has been chairman of the board and chief executive officer since its inception in 1985. From 1985 to June 1994, Mr. Schultz was also the Company's president. From September 1982 to December 1985, Mr. Schultz was the director of Retail Operations and Marketing for Starbucks Coffee Company, a predecessor to the Company; and from January 1986 to July 1987, he was the chairman of the board, chief executive officer and president of Il Giornale Coffee Company, a predecessor to the Company.

ORIN SMITH joined the Company in 1990 and has served as president and chief operating officer of the Company since June 1994. Prior to June 1994, Mr. Smith served as the Company's vice president and chief financial officer and later, as its executive vice president and chief financial officer.

HOWARD BEHAR joined the Company in 1989 and has served as president of Starbucks Coffee International, Inc. since June 1994. From February 1993 to June 1994, Mr. Behar served as the Company's executive vice president, Sales and Operations. From February 1991 to February 1993, Mr. Behar served as senior vice president, Retail Operations of the Company and from August 1989 to January 1991, he served as the Company's vice president, Retail Stores.

JOHN RICHARDS joined the Company in September 1997 as president, Retail, North America. Prior to joining the Company, Mr. Richards served as the Executive Vice President of Four Seasons Hotels and Resorts for 10 years. Prior to that time Mr. Richards held various positions with McKinsey & Company and Procter & Gamble.

MICHAEL CASEY joined Starbucks in August 1995 as senior vice president and chief financial officer and was promoted to executive vice president, chief financial officer and chief administrative officer in September 1997. Prior to joining Starbucks, Mr. Casey served as executive vice president and chief financial officer of Family Restaurants, Inc. from its inception in 1986. During his tenure there, he also served as a director from 1986 to 1993, and as president and chief executive officer of its El Torito Restaurants, Inc. subsidiary from 1988 to 1993.

E. R. (TED) GARCIA joined Starbucks in April 1995 as senior vice president, Supply Chain Operations and was promoted to executive vice president, Supply Chain Operations in September 1997. From May 1993 to April 1995, Mr. Garcia was an executive for Gemini Consulting. From January 1990 until May 1993, he was the vice president of Operations Strategy for Grand Metropolitan PLC, Food Sector.

DEIDRA WAGER joined Starbucks in 1992 and served as the Company's senior vice president, Retail Operations from August 1993 to September 1997 when she was promoted to executive vice president, Retail Marketing and Operations Services. From September 1992 to August 1993, Ms. Wager served as the Company's vice president, Operation Services. From March 1992 to September 1992, she was the Company's California regional manager. From September 1988 to March 1992, Ms. Wager held several operations positions with Taco Bell (R), Inc., including having served as its director of operations systems development.

JAMES ALLING joined Starbucks in September 1997 as senior vice president, Grocery. From 1985 to 1997, Mr. Alling held several marketing and general management positions for Nestle, U.S.A., including serving as the vice president and general manager of the ground coffee division.

SCOTT BEDBURY joined Starbucks in June 1995 as senior vice president, Marketing and became the senior vice president, Brand Development in November 1997. From November 1987 to October 1994, Mr. Bedbury held the position of worldwide director of advertising for Nike, Inc. Prior to joining Nike, Inc., Mr. Bedbury was vice president for Cole and Weber Advertising in Seattle, Washington, which is an affiliate of Ogilvy and Mather.

BRUCE CRAIG joined Starbucks in October 1992 and served as regional and then zone vice president for the Southwest. In September 1997, Mr. Craig was promoted to the position of senior vice president, Retail Field Operations. Prior to joining Starbucks, Mr. Craig served for 21 years with Burger King Corp. in various positions, including executive vice president/division manager and as an owner/operator.

VINCENT EADES joined Starbucks in April 1995 as senior vice president, Specialty Sales and Marketing. From February 1993 to April 1995, Mr. Eades served as a regional sales manager for Hallmark Cards, Inc. From August 1989 to February 1993, Mr. Eades was general manager of the Christmas Celebrations business unit at Hallmark Cards, Inc.

SHARON E. ELLIOTT joined Starbucks in 1994 as senior vice president, Human Resources. From September 1993 to June 1994, Ms. Elliott served as the corporate director, staffing and development of Allied Signal Corporation. From July 1987 to August 1993, she held several human resources management positions with Bristol-Myers Squibb, including serving as the director of human resources--corporate staff.

DEBORAH J. GILLOTTI joined Starbucks in February 1997 as senior vice president and chief information officer. Prior to joining Starbucks, Ms. Gillotti served as vice president, Corporate MIS for Duracell International, Inc. (now a division of the Gillette Company). She also held several management positions for KPMG Peat Marwick Management Consulting from 1989 to 1993.

WANDA HERNDON, joined Starbucks in July 1995 as vice president, Communications and Public Affairs and was promoted to senior vice president, Communication and Public Affairs in November 1996. From February 1990 to June 1995, Ms. Herndon held several communications management positions at DuPont. From November 1978 to February 1990, Ms. Herndon held several public affairs and marketing communications positions for Dow Chemical Company.

SHELLEY B. LANZA joined Starbucks in June 1995 as senior vice president, Law and Corporate Affairs and general counsel. From 1986 to 1995, Ms. Lanza served as vice president and general counsel of Honda of America Manufacturing, Inc. From 1982 to 1986, Ms. Lanza practiced law at the law firm of Vorys, Sater, Seymour and Pease in Columbus, Ohio.

JUDY MELELIAT joined Starbucks in October 1997 as vice president, Marketing Operations and was promoted to senior vice president, Marketing in November 1997. Prior to joining Starbucks, Ms. Meleliat was vice president of Marketing for InfoAccess. From September 1995 to June 1996, she served at Edmark Corporation as the vice president of Sales for the Education Channel. From September 1987 to September 1995, Ms. Meleliat held several executive management positions at Egghead Software.

DAVID M. OLSEN joined Starbucks in 1986 and served as the Company's senior vice president, Coffee from September 1991 to October 1997. From November 1987 to September 1991, Mr. Olsen served as vice president, Coffee, and from February 1986 to November 1987, he served as the Company's director of training.

ARTHUR I. RUBINFELD joined the Company in 1992 as senior vice president, Real Estate. From April 1986 to May 1992, Mr. Rubinfeld served as a managing partner of Epsteen & Associates, a commercial real estate company.

DON VALENCIA joined Starbucks in November 1993 as vice president, Research and Development and was promoted to senior vice president, Research and Development in October 1997. From 1980 to 1993, Mr. Valencia was president of Immuno Concepts, Incorporated, a biomedical company.

MARY WILLIAMS joined Starbucks in March 1993 as vice president, Green Coffee and was promoted to senior vice president, Coffee in October 1997. From May 1988 to March 1993, Ms. Williams served as president of Klein Bros. International, Coffee Division.

There are no family relationships between any directors or executive officers of the Company.

**ITEM 11. EXECUTIVE COMPENSATION**

The information required by this item is incorporated by reference to the section entitled "Executive Compensation" in the Company's Proxy Statement.

**ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT**

The information required by this item is incorporated by reference to the section entitled "Beneficial Ownership of Common Stock" in the Company's Proxy Statement.

**ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS**

The information required by this item is incorporated by reference to the section entitled "Executive Compensation - Certain Transactions" in the Company's Proxy Statement.

## PART IV

### ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

(a) The following documents are filed as a part of this Annual Report on Form l0-K:

1.Financial Statements.

The following financial statements incorporated by reference to the Company's 1997 Annual Report to Shareholders in Part II, Item 8:

Consolidated Balance Sheets as of September 28, 1997 and September 29, 1996;

Consolidated Statements of Earnings for the fiscal years ending September 28, 1997, September 29, 1996 and October 1, 1995; Consolidated Statements of Cash Flows for the fiscal years ending September 28, 1997, September 29, 1996 and October 1, 1995; Consolidated Statements of Shareholders' Equity for the fiscal years ending September 28, 1997, September 29, 1996 and October 1, 1995;

**Notes to Consolidated Financial Statements.**

2.Financial Statement Schedules.

Financial statement schedules are omitted because they are not required or are not applicable, or the required information is provided in the consolidated financial statements or notes thereto described in Item 14(a)(1) above.

3.Exhibits.

The Exhibits listed below and on the accompanying Index to Exhibits immediately following the signature page hereto are filed as part of, or incorporated by reference into, this Annual Report on Form 10-K.

| Exhibit No. | Description |
|---|---|
| 3.1 | Restated Articles of Incorporation of Starbucks Corporation (incorporated herein by reference to Exhibit 3. 1 to the Company's Form 10-Q for the fiscal quarter ended March 31, 1996, filed with the SEC on May 15, 1996) |
| 3.1.1 | Amendment dated November 22, 1995 to the Restated Articles of Incorporation of Starbucks Corporation (incorporated herein by reference to Exhibit 3.1.1 to the Company's Form 10-Q for the fiscal quarter ended March 31, 1996, filed with the SEC on May 15, 1996) |
| 3.1.2 | Amendment dated March 18, 1996 to the Restated Articles of Incorporation of Starbucks Corporation (incorporated herein by reference to Exhibit 3.1.2 to the Company's Form 10-Q for the quarterly period ended March 31, 1996, filed with the SEC on May 15, 1996) |
| 3.2 | Amended and Restated Bylaws of Starbucks Corporation (incorporated herein by reference to Exhibit 3.2 to the Company's Form 10-Q for the fiscal quarter ended March 31, 1996, filed with the SEC on May 15, 1996) |

| | |
|---|---|
| 4.1 | Indenture, dated as of October 24, 1995, between Starbucks Corporation and First Interstate Bank of Washington, N.A., as Trustee (incorporated herein by reference to Exhibit 4.3 to the Company's Form l0-K for the fiscal year ended October 1, 1995, filed with the SEC on December 28, 1995) |
| 4.2 | Form of Debenture relating to the Indenture described in Exhibit 4.1 hereto (incorporated herein by reference to Exhibit 4.4 to the Company's Form l0-K for the fiscal year ended October 1, 1995, filed with the SEC on December 28, 1995) |
| 10.1 | Starbucks Corporation Key Employee Stock Option Plan--1994 (incorporated herein by reference to Appendix A to the Company's 1994 Proxy Statement filed with the SEC on December 23, 1994)* |
| 10.1.1 | Starbucks Corporation Key Employee Stock Option Plan-- 1994, as amended (incorporated herein by reference to Exhibit 10.1.1 to the Company's Form 10-K for the fiscal year ended September 29, 1996, filed with the SEC on December 26, 1996)* |
| 10.2 | Starbucks Corporation 1989 Stock Option Plan for Non-Employee Directors, as amended (incorporated herein by reference to Appendix B to the Company's 1994 Proxy Statement filed with the SEC on December 23, 1994)* |
| 10.2.1 | Starbucks Corporation 1989 Stock Option Plan for Non-Employee Directors, as amended (incorporated herein by reference to Exhibit 10.2.1 to the Company's Form 10-K for the fiscal year ended on September 29, 1996, filed with the SEC on December 26, 1996)* |
| 10.3 | Starbucks Corporation 1991 Company-Wide Stock Option Plan, as amended (incorporated herein by reference to the Company's Registration Statement No. 33-52528 on Form S-8, filed with the SEC on September 28, 1992)* |
| 10.3.1 | Starbucks Corporation 1991 Company-Wide Stock Option Plan, as amended (incorporated by reference to Exhibit 10.3.1 to the Company's Annual Report on Form 10-K for the fiscal year ended September 29, 1996, filed with the SEC on December 26, 1996)* |
| 10.4 | Starbucks Corporation Employee Stock Purchase Plan --1995 (incorporated herein by reference to Appendix C to the Company's 1994 Proxy Statement filed with the SEC on December 23, 1994)* |
| 10.5 | Industrial Lease, dated March 31, 1989, between Starbucks Corporation and the City of Seattle (successor in interest to David A. Sabey and Sandra L. Sabey) (incorporated herein by reference to Exhibit 10.4 to the Company's Registration Statement No. 33-47951 on Form S-1, filed with the SEC on May 15, 1992) |
| 10.6 | Office Lease, dated as of July 15, 1993, between First and Utah Street Associates, L.P. and Starbucks Corporation (incorporated herein by reference to Exhibit 10.17 to the Company's Form 10-K for the Fiscal Year ended October 3, 1993, filed with the SEC on December 30, 1993) |
| 10.6.1 | Second Amendment to Office Lease, dated as of January 1, 1995, between First & Utah Street Associates, L.P. and Starbucks Corporation (incorporated herein by reference to the Company's Registration Statement No. 33-93974 on Form S-3, filed with the SEC on June 27, 1995) |

| | |
|---|---|
| 10.6.2 | Third Amendment to Office Lease, dated as of September 30, 1995, between First and Utah Street Associates, L.P. and Starbucks Corporation (incorporated herein by reference to Exhibit 10.19 to the Company's Form 10-K for the fiscal year ended October l, 1995, filed with the SEC on December 28, 1995) |
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| 10.9 | Joint Venture and Partnership Agreement, dated August 10, 1994, between Pepsi-Cola Company, a division of PepsiCo, Inc., and Starbucks New Venture Company (incorporated herein by reference to Exhibit 10 to the Company's Form 10-Q for the Quarterly Period ended July 3, 1994, filed with the SEC on August 16, 1994) |
| 10.10 | Lease, dated August 22, 1994, between York County Industrial Development Corporation and Starbucks Corporation (incorporated herein by reference to Exhibit l0 to the Company's Form 10-Q for the Quarterly Period Ended July 2, 1995, filed with the SEC on August 15, 1995) |
| 10.11 | Starbucks Corporation Amended and Restated Consulting/Employment Agreement with Jeffrey H. Brotman, dated as of January 14, 1995 (incorporated herein by reference to Exhibit 10.14 to the Company's Form 10-K for the Fiscal Year ended October l, 1995, filed with the SEC on December 28, 1995)* |
| 10.12 | Protective Covenants Agreement dated March 31, 1995, among Starbucks Corporation, Noah's New York Bagels, Inc. and certain shareholders of Noah's New York Bagels, Inc. (incorporated herein by reference to the Company's Registration Statement No. 33-91780 on Form S-3, filed with the SEC on April 28, 1995) |
| 10.13 | Merger Agreement among Noah's New York Bagels, Inc. Shareholders and Certain Optionholders of Noah's New York Bagels, Inc., Einstein Brothers Bagels, Inc. and NNYB Acquisition Corporation, dated January 22, 1996 (incorporated herein by reference to Exhibit 10.21 to the Company's Form 10-Q for the Quarterly Period Ended March 31, 1996, filed with the SEC on May 15, 1996) |
| 10.13.1 | Amendment dated February l, 1996, to Merger Agreement among Noah's New York Bagels, Inc., Shareholders and Certain Optionholders of Noah's New York Bagels, Inc., Einstein Brothers Bagels, Inc. and NNYB Acquisition Corporation dated January 22, 1996 (incorporated herein by reference to Exhibit 10.22 to the Company's Form 10-Q for the Quarterly Period Ended March 31, 1996, filed with the SEC on May 15, 1996) |
| 10.14 | Master Licensing Agreement between the Company and ARAMARK Food and Services Group, Inc. dated as of January 30, 1996, as amended and restated May 7, 1996 (incorporated herein by reference to Exhibit 10.23 to the Company's Form l0-Q for the Quarterly Period Ended March 31, 1996, filed with the SEC on May 15, 1996) |
| 11 | Computation of Per Share Earnings |
| 12 | Ratio of Earnings to Fixed Charges |

| | |
|---|---|
| 13 | Portions of the 1997 Annual Report to Shareholders |
| 21 | Subsidiaries of the Registrant |
| 23 | Independent Auditors' Consent |
| 27 | Financial Data Schedule |

* Management contract or compensatory plan or arrangement.

(b) Reports on Form 8-K.

No reports on Form 8-K were filed by the Company during the fiscal quarter ended September 28, 1997.

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**STARBUCKS CORPORATION**

*By: /s/ Howard Schultz*
*Howard Schultz*
*chairman of the Board of Directors*
*and chief executive officer*

*December 19, 1997*

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

| Signature | Title | Date |
|---|---|---|
| /s/ Howard Schultz<br>Howard Schultz | chairman of the Board of Directors and chief executive officer | December 19, 1997 |
| /s/ Orin C. Smith<br>Orin C. Smith | director, president and chief operating officer | December 16, 1997 |
| /s/ Howard Behar<br>Howard Behar | director, president of Starbucks Coffee International, Inc. | December 19, 1997 |
| /s/ Michael Casey<br>Michael Casey | executive vice president, chief financial officer and chief administrative officer (principal financial officer and principal accounting officer) | December 19, 1997 |
| /s/ Barbara Bass<br>Barbara Bass | director | December 15, 1997 |
| /s/ Jeffrey H. Brotman<br>Jeffrey H. Brotman | director | December 22, 1997 |
| /s/ Craig J. Foley<br>Craig J. Foley | director | December 16, 1997 |
| /s/ Arlen I. Prentice<br>Arlen I. Prentice | director | December 15, 1997 |
| /s/ James G. Shennan, Jr.<br>James G. Shennan, Jr. | director | December 12, 1997 |

# EXHIBIT INDEX

| Exhibit No. | Description | Page No. |
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| 3.1 | Restated Articles of Incorporation of Starbucks Corporation (incorporated herein by reference to Exhibit 3.1 to the Company's Form 10-Q for the fiscal quarter ended March 31, 1996, filed with the SEC on May 15, 1996) | |
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| 10.13.1 | Amendment dated February l, 1996, to Merger Agreement among Noah's New York Bagels, Inc., Shareholders and Certain Optionholders of Noah's New York |

Bagels, Inc., Einstein Brothers Bagels, Inc. and NNYB Acquisition Corporation dated January 22, 1996 (incorporated herein by reference to Exhibit 10.22 to the Company's Form 10-Q for the Quarterly Period Ended March 31, 1996, filed with the SEC on May

| | | |
|---|---|---|
| | 15, 1996) | |
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| 11 | Computation of Per Share Earnings | E-4 |
| 12 | Ratio of Earnings to Fixed Charges | E-5 |
| 13 | Portions of the 1997 Annual Report to Shareholders | E-6 |
| 21 | Subsidiaries of the Registrant | E-34 |
| 23 | Independent Auditors' Consent | E-35 |
| 27 | Financial Data Schedule | E-36 |

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* Management contract or compensatory plan or arrangement.

**EXHIBIT 11**

**COMPUTATION OF PER SHARE EARNINGS**

(in thousands, except earnings per share)

| | September 28, 1997 | September 29, 1996 | October 1, 1995 |
|---|---|---|---|
| CALCULATION OF EARNINGS PER COMMON AND COMMON EQUIVALENT SHARE - PRIMARY: | | | |
| Net earnings ($) | 57,412 | 42,128 | 26,102 |
| Weighted average shares outstanding calculation: | | | |
| Weighted average number of common shares outstanding | 78,359 | 73,849 | 68,898 |
| Dilutive effect of outstanding common stock options and warrants | 3,279 | 3,115 | 2,411 |
| Weighted average shares outstanding | 81,638 | 76,964 | 71,309 |
| Earnings per share ($) | 0.70 | 0.55 | 0.37 |
| CALCULATION OF EARNINGS PER COMMON AND COMMON EQUIVALENT SHARE | | | |
| - FULLY DILUTED(1): | | | |
| Net earnings calculation: | | | |
| Net earnings ($) | 57,412 | 42,128 | 26,102 |
| Add after tax interest expense on debentures | 4,300 | 1,248 | -- |
| Add after tax amortization of issuance costs related to the debentures | 354 | 93 | -- |
| Adjusted net earnings ($) | 62,066 | 43,469 | 26,102 |
| Weighted average shares outstanding calculation: | | | |
| Weighted average number of common shares outstanding | 78,359 | 73,849 | 68,898 |
| Dilutive effect of outstanding common stock options and warrants | 3,774 | 3,956 | 3,011 |
| Assuming conversion of convertible subordinated debentures | 7,098 | 3,026 | -- |
| Weighted average shares outstanding | 89,231 | 80,831 | 71,909 |
| Earnings per common and common equivalent share - fully diluted ($) | 0.70 | 0.54 | 0.36 |

(1) Fully diluted earnings per share assumes conversion of the Company's convertible subordinated debentures using the "if converted" method, when such securities are dilutive, with income adjusted for the after-tax interest expense and amortization applicable to these debentures.

# EXHIBIT 12

## STATEMENT REGARDING COMPUTATION OF RATIO OF EARNINGS TO FIXED CHARGES(1)

(in thousands, except ratio data)

| | September 28, 1997 | September 29, 1996 | October 1, 1995 | October 2, 1994 | October 3, 1993 |
|---|---|---|---|---|---|
| COMPUTATION OF EARNINGS: | | | | | |
| Earnings before income taxes ($) | 93,349 | 68,501 | 43,143 | 17,754 | 13,526 |
| Interest expense | 7,266 | 8,739 | 3,765 | 3,807 | 772 |
| Amortization of debt expense | 578 | 682 | 260 | 260 | 43 |
| Portion of rents representative of interest factor | 27,054 | 20,612 | 14,713 | 7,144 | 3,892 |
| Less: Capitalized interest | (241) | (306) | (160) | (99) | -- |
| Total earnings (as calculated) ($) | 128,006 | 98,228 | 61,721 | 28,866 | 18,233 |
| COMPUTATION OF FIXED CHARGES: | | | | | |
| Interest expense ($) | 7,266 | 8,739 | 3,765 | 3,807 | 772 |
| Amortization of debt expense | 578 | 682 | 260 | 260 | 43 |
| Portion of rents representative of interest factor | 27,054 | 20,612 | 14,713 | 7,144 | 3,892 |
| Total fixed charges ($) | 34,898 | 30,033 | 18,738 | 11,211 | 4,707 |
| Ratio of earnings to fixed charges | 3.67x | 3.27x | 3.29x | 2.57x | 3.87x |

(1) For purposes of computing the ratio of earnings to fixed charges, earnings include earnings before income taxes, amortization of debt expense, and interest expense, including that portion of rental expense attributable to interest costs. Fixed charges consist of interest expense, including that portion of rental expense attributable to interest costs, and interest capitalized during the period.

**EXHIBIT 13**

**PORTIONS OF THE 1997 ANNUAL REPORT TO SHAREHOLDERS**

**SHAREHOLDER INFORMATION**
**STARBUCKS CORPORATION**

Market Information and Dividend Policy The Company's Common Stock is traded on the National Market tier of The Nasdaq Stock Market, Inc. ("Nasdaq") under the symbol "SBUX". The following table sets forth the quarterly high and low sale prices per share of the Common Stock as reported by Nasdaq for each quarter during the last two fiscal years, retroactively adjusted for the two-for-one stock split on December 1, 1995.

| Fiscal year ended | High | Low |
|---|---|---|
| September 28, 1997 | | |
| First Quarter | $40 1/4 | $28 7/8 |
| Second Quarter | 37 1/4 | 27 3/8 |
| Third Quarter | 39 1/2 | 26 1/8 |
| Fourth Quarter | 44 3/4 | 34 1/8 |
| September 29, 1996 | | |
| First Quarter | $23 1/2 | 16 15/16 |
| Second Quarter | 23 5/8 | 14 1/2 |
| Third Quarter | 29 5/8 | 24 1/8 |
| Fourth Quarter | 35 7/8 | 23 |

As of December 1, 1997, the Company had 7,209 shareholders of record. The Company has never paid any dividends on its Common Stock. The Company presently intends to retain earnings for use in its business and therefore does not anticipate declaring and paying a cash dividend in the near future.

Form 10-K and Quarterly Shareholder Information The Company's annual report on Form 10-K for the fiscal year ended September 28, 1997, without the Exhibits thereto, may be obtained without charge by sending a written request to Investor Relations at the address below.

Quarterly information is available to all shareholders immediately upon its release, free of charge, via fax, by calling (800) 239-0317 or through access on the Internet at www.businesswire.com/cnn/sbux.htm. To receive a copy by mail, please send your written request to:

Investor Relations - M/S S-FP1
Starbucks Corporation
P.O. Box 34067
Seattle, WA 98124-1067

## SELECTED FINANCIAL DATA

(in thousands, except earnings per share)

The following selected financial data have been derived from the consolidated financial statements of the Company. The data set forth below should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the Company's consolidated financial statements and notes thereto.

| As of and for the fiscal year ended: | Sept 28, 1997 (52 Wks) | Sept 29, 1996 (52 Wks) | Oct 1, 1995 (52 Wks) | Oct 2, 1994 (52 Wks) | Oct 3, 1993 (53 Wks) |
|---|---|---|---|---|---|
| Results of Operations Data: | | | | | |
| Net revenues | | | | | |
| Retail | $828,074 | $600,067 | $402,655 | $248,495 | $153,610 |
| Specialty Sales | 117,635 | 78,655 | 48,143 | 26,543 | 15,952 |
| Direct Response | 21,237 | 17,759 | 14,415 | 9,885 | 6,979 |
| Total net revenues | 966,946 | 696,481 | 465,213 | 284,923 | 176,541 |
| Operating income | 88,222 | 56,993 | 40,116 | 23,298 | 12,618 |
| Provision for merger costs(1) | -- | -- | -- | 3,867 | -- |
| Gain on sale of investment in Noah's(2) | -- | 9,218 | -- | -- | -- |
| Net earnings | $ 57,412 | $ 42,128 | $ 26,102 | $ 10,206 | $ 8,282 |
| Net earnings per common and common equivalent share fully diluted(3) | $ 0.70 | $ 0.54 | $ 0.36 | $ 0.17 | $ 0.14 |
| Cash dividends per share | -- | -- | -- | -- | -- |
| Balance Sheet Data: | | | | | |
| Working capital | $177,578 | $238,450 | $134,304 | $ 44,162 | $ 42,092 |
| Total assets | 850,672 | 726,613 | 468,178 | 231,421 | 201,712 |
| Long-term debt (including current portion) | 168,832 | 167,980 | 81,773 | 80,500 | 82,100 |
| Redeemable preferred stock | -- | -- | -- | -- | 4,944 |
| Shareholders equity | $531,830 | $451,660 | $312,231 | $109,898 | $ 88,686 |
| Store Operating Data: | | | | | |
| Percentage change in comparable store sales(4) | 5% | 7% | 9% | 9% | 19% |
| Stores open at year end - North America: | | | | | |
| Company-operated stores | 1,270 | 929 | 627 | 399 | 260 |
| Licensed stores (5) | 94 | 75 | 49 | 26 | 12 |
| | 1,364 | 1,004 | 676 | 425 | 272 |
| Stores open at year end - outside North America: | | | | | |
| Licensed stores(5) | 17 | 2 | -- | -- | -- |
| Total stores | 1,381 | 1,006 | 676 | 425 | 272 |

(1) Provision for merger costs reflects expenses related to the merger with The Coffee Connection, Inc. in fiscal 1994.

(2) Gain on sale of investment in Noah's results from the sale of Noah's New York Bagel, Inc. ("Noah's") stock in fiscal 1996.

(3) Earnings per share is based on the weighted average shares outstanding during the period plus, when their effect is dilutive, common stock equivalents consisting of certain shares subject to stock options. Fully diluted earnings per share assumes conversion of the Company's convertible subordinated debentures using the "if converted" method, when such securities are dilutive, with net income adjusted for the after-tax interest expense and amortization applicable to these debentures.

(4) Includes only Company-operated stores open 13 months or longer.

(5) Operated by licensees through either licensing agreements or joint ventures. Product sales to and royalties and fees from the Company's licensees are included in the Company's specialty sales revenues. Joint ventures are accounted for on the equity method and therefore the operations are not consolidated into the Company's operations.

Cautionary Statement pursuant to the Private Securities Litigation Reform Act Of 1995

Certain statements set forth in this Annual Report, including anticipated store openings, planned capital expenditures, and trends in or expectations regarding the Company's operations 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 risks and uncertainties. Actual future results and trends may differ materially depending on a variety of factors, including, but not limited to, coffee and other raw materials prices and availability, successful execution of internal performance and expansion plans, the impact of competition, availability of financing, the volatility of interest rates and securities prices, the effect of legal proceedings, and other risks detailed herein and in the Company's Securities and Exchange Commission filings, including the Company's Annual Report on Form 10-K for the fiscal year ended September 28, 1997.

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

General Starbucks presently derives approximately 86% of net revenues from its Company-operated retail stores. The Company's specialty sales operations, which include product sales to and royalties and fees from wholesale customers, licensees, and joint ventures, accounted for approximately 12% of net revenues in fiscal 1997. Direct response operations accounted for the remainder of net revenues.

The Company's net revenues increased from $465.2 million in fiscal 1995 to $966.9 million in fiscal 1997, due primarily to the Company's store expansion program and comparable store sales increases. Comparable store sales increased by 5%, 7%, and 9% in fiscal 1997, 1996, and 1995, respectively. As part of its expansion strategy of clustering stores in existing markets, Starbucks has experienced a certain level of cannibalization of existing stores by new stores as the store concentration has increased. However, management believes such cannibalization has been justified by the incremental sales and return on new store investment. This cannibalization, as well as increased competition and other factors, may continue to put downward pressure on the Company's comparable store sales growth in future periods.

The Company's fiscal year ends on the Sunday closest to September 30. Fiscal years 1997, 1996, and 1995 each had 52 weeks.

The following table sets forth the percentage relationship to total net revenues, unless otherwise indicated, of certain items included in the Company's consolidated statements of earnings:

| Fiscal year ended: | Sept 28, 1997 (52 Wks) | Sept 29, 1996 (52 Wks) | Oct 1, 1995 (52 Wks) |
|---|---|---|---|
| Statements of Earnings Data: | | | |
| Net revenues | | | |
| Retail | 85.6% | 86.2% | 86.6% |
| Specialty Sales | 12.2 | 11.3 | 10.3 |
| Direct Response | 2.2 | 2.5 | 3.1 |
| Total net revenues | 100.0 | 100.0 | 100.0 |
| Cost of sales and related occupancy costs | 44.7 | 48.2 | 45.4 |
| Store operating expenses(1) | 37.3 | 35.1 | 36.9 |
| Other operating expenses | 2.9 | 2.8 | 3.0 |
| Depreciation and amortization | 5.4 | 5.2 | 4.8 |
| General and administrative expenses | 5.9 | 5.3 | 6.2 |
| Operating income | 9.1 | 8.2 | 8.6 |
| Interest and other income | 1.3 | 1.6 | 1.5 |
| Interest expense | (0.8) | (1.3) | (0.8) |
| Gain on sale of investment in Noah's | 0.0 | 1.3 | 0.0 |
| Earnings before income taxes | 9.6 | 9.8 | 9.3 |
| Income taxes | 3.7 | 3.8 | 3.7 |
| Net earnings | 5.9% | 6.0% | 5.6% |

(1) Shown as a percentage of retail sales.

## RESULTS OF OPERATIONS - FISCAL 1997 COMPARED TO FISCAL 1996

Revenues Net revenues increased 39% to $966.9 million for fiscal 1997, compared to $696.5 million for fiscal 1996. Retail sales increased 38% to $828.1 million from $600.1 million. The increase in retail sales was due primarily to the addition of new Company-operated stores. In addition, comparable store sales increased 5% for the 52 weeks ended September 28, 1997 compared to the same 52- week period in fiscal 1996. Comparable store sales increases resulted from an increase in the number of transactions combined with an increase in the average dollar value per transaction. During fiscal 1997, the Company opened 341 Starbucks stores. The Company opened stores in the new major markets of Phoenix, Detroit and Miami, as well as 15 smaller markets in continental North America and ended the fiscal year with 1,270 Company-operated stores in continental North America.

Specialty Sales revenues increased 50% to $117.6 million for fiscal 1997 from $78.7 million for fiscal 1996. The increase was due primarily to increased revenues from sales to the Company's joint ventures, a chain of wholesale clubs, and business dining accounts. The Company sells roasted coffee to its joint venture with Pepsi-Cola Company, a division of PepsiCo, Inc. for use in the manufacture of its bottled Frappuccino (TM) beverage, and coffee extract to Dreyer's Grand Ice Cream, Inc. for use in the manufacture of Starbucks branded ice cream sold by the Company's joint venture with Dreyer's. Licensees (including those in which the Company is a joint venture partner) opened 20 stores and closed one store in continental North America and opened 15 stores in the Pacific Rim. The Company ended the year with 94 licensed stores in continental North America and 17 in the Pacific Rim. Direct Response sales increased 20% to $21.2 million for fiscal 1997 from $17.8 million for fiscal 1996.

Costs and Expenses Cost of sales and related occupancy costs as a percentage of net revenues decreased to 44.7% for fiscal 1997 compared to 48.2% for fiscal 1996. This decrease was primarily the result of lower green coffee costs as a percentage of net revenues and, to a much lesser extent, the impact of sales price increases. Management expects cost of sales as a percentage of net revenues in fiscal 1998 to increase relative to fiscal 1997 as higher cost coffees are reflected in cost of sales.

Store operating expenses as a percentage of retail sales increased to 37.3% for fiscal 1997 from 35.1% for fiscal 1996. This was due to higher advertising expenses and higher payroll-related costs.

Other operating expenses (expenses associated with the Company's specialty sales, direct response, and international operations, as well as the Company's share of joint venture profits and losses) increased to 2.9% of net revenues for fiscal 1997 from 2.8% for fiscal 1996. The increase was attributable to higher payroll-related costs offset by lower business taxes and improved contribution from joint ventures. Management anticipates that the joint ventures with Pepsi and Dreyer's will be profitable in fiscal 1998 and that the international operations will remain dilutive to earnings in fiscal 1998. Depreciation and amortization as a percentage of net revenues increased to 5.4% for fiscal 1997 from 5.2% for fiscal 1996.

General and administrative expenses were 5.9% of net revenues for fiscal 1997 compared to 5.3% for fiscal 1996. This increase was due primarily to higher payroll-related costs which were tightly constrained in 1996.

Interest and Other Income Interest and other income for fiscal 1997 was $12.4 million, compared to $11.0 million for fiscal 1996. The increase was due to gains on sales of investments and higher average interest rates earned on investments, partially offset by lower average investment balances during fiscal 1997.

Interest Expense Interest expense for fiscal 1997 was $7.3 million compared to $8.7 million for fiscal 1996. The decrease in interest expense is due to the conversion of the Company's $80.5 million of 4 1/2% Convertible Subordinated Debentures during the third quarter of fiscal 1996. Management believes that interest expense will be lower in fiscal 1998 due to the conversion of substantially all of the Company's $165.0 million of 4 1/4% Convertible Subordinated Debentures into approximately 7.1 million shares of the Company's common stock following the Company's October 21, 1997 call for redemption.

Income Taxes The Company's effective tax rate for fiscal 1997 was 38.5% which was unchanged from fiscal 1996. Management does not anticipate any significant fluctuations in the tax rate for fiscal 1998.

## RESULTS OF OPERATIONS - FISCAL 1996 COMPARED TO FISCAL 1995

Revenues Net revenues increased 50% to $696.5 million for fiscal 1996, compared to $465.2 million for fiscal 1995. Retail sales increased 49% to $600.1 million from $402.7 million. The increase in retail sales was due primarily to the addition of new Company- operated stores. In addition, comparable store sales increased 7% for the 52 weeks ended September 29, 1996 compared to the same 52- week period in fiscal 1995. Comparable store sales increases resulted from an increase in the number of transactions combined with an increase in the average dollar value per transaction.

During fiscal 1996, the Company opened 307 Starbucks stores (including four replacement stores), converted 19 Coffee Connection stores to Starbucks stores, and closed one store. Licensees opened 26 stores. The Company opened stores in several new markets including North Carolina, Rhode Island, and Ontario, Canada. The Company ended the fiscal year with 929 Company-operated stores and 75 licensed stores in North America.

Specialty Sales revenues increased 63% to $78.7 million for fiscal 1996 from $48.1 million for fiscal 1995. The increase was due primarily to the Company signing an agreement with a major U.S. airline as well as increased revenues from several hotels, a chain of wholesale clubs, office coffee distributors, and restaurants. Direct Response sales increased 23% to $17.8 million for fiscal 1996 from $14.4 million for fiscal 1995.

Costs and Expenses Cost of sales and related occupancy costs as a percentage of net revenues increased to 48.2% for fiscal 1996 compared to 45.4% for fiscal 1995. This increase was primarily the result of higher green coffee costs as a percentage of net revenues, partially offset by a shift in retail sales mix towards higher-margin products.

Store operating expenses as a percentage of retail sales decreased to 35.1% for fiscal 1996 from 36.9% for fiscal 1995. This improvement reflected lower retail advertising expense, store remodel expense, and preopening expense as a percentage of retail sales.

Other operating expenses (those associated with the Company's specialty sales and direct response operations as well as the Company's joint ventures) decreased to 2.8% of net revenues for fiscal 1996 from 3.0% for fiscal 1995 primarily from operational leverage on the Company's net revenue increase. Depreciation and amortization as a percentage of net revenues increased to 5.2% for fiscal 1996 from 4.8% for fiscal 1995. This increase was primarily the result of increased per-store buildout costs in recent years relative to earlier history. After several years of increased per-store buildout costs, average store buildout costs declined in fiscal 1996 relative to fiscal 1995.

General and administrative expenses as a percentage of net revenues were 5.3% for fiscal 1996 compared to 6.2% for fiscal 1995. This decrease as a percentage of revenues was due primarily to lower payroll-related costs and professional fees as a percentage of net revenues.

Operating Income Operating income for fiscal 1996 increased to $57.0 million (8.2% of net revenues) from $40.1 million (8.6% of net revenues) for fiscal 1995. Operating income as a percentage of net revenues decreased due to higher cost of sales and an increase in depreciation and amortization, partially offset by lower store operating expenses, general and administrative expenses, and other operating expenses as a percentage of revenues.

Interest and Other Income Interest and other income for fiscal 1996 was $11.0 million compared to $6.8 million for fiscal 1995. Average investment balances were higher during fiscal 1996 as a result of proceeds from the Company's October 1995 offering of 4 1/4% Convertible Subordinated Debentures due 2002, which generated $161.0 million, net of issuance costs.

Gain on Sale of Investment in Noah's In March 1995, the Company invested $11.3 million in cash for shares of Noah's New York Bagel, Inc. ("Noah's") Series B Preferred Stock. On February 1, 1996, Noah's was merged with Einstein Brothers Bagels, Inc., a retailer operating primarily in the Eastern United States. In exchange for its investment in Noah's, the Company received $20.6 million in cash and recognized a $9.2 million pre-tax gain ($5.7 million, net of tax) on the transaction.

Interest Expense Interest expense for fiscal 1996 was $8.7 million compared to $3.8 million for fiscal 1995. The increase in interest expense is due to the Company's convertible subordinated debentures issued in October 1995.

Income Taxes The Company's effective tax rate for fiscal 1996 was 38.5% compared to 39.5% for fiscal 1995. The Company's fiscal 1996 effective tax rate was lower than in fiscal 1995 due primarily to changes in state tax allocations and apportionment factors as well as the implementation of tax-saving strategies.

## LIQUIDITY AND CAPTIAL RESOURCES

The Company ended fiscal 1997 with $158.8 million in total cash and investments. Working capital as of September 28, 1997 totaled $177.6 million compared to $238.5 million at September 29, 1996. Cash and cash equivalents decreased by $56.1 million during fiscal 1997 to $70.1 million at September 28, 1997.

Cash provided by operating activities for fiscal 1997 totaled $101.0 million and resulted primarily from net income before non-cash charges of $124.8 million, partially offset by a $36.2 million increase in inventories.

Cash used by investing activities for fiscal 1997 totaled $187.0 million. This included capital additions to property, plant, and equipment of $169.7 million related to opening 341 new Company-operated retail stores and remodeling certain existing stores, purchasing roasting and packaging equipment for the Company's roasting and distribution facilities, enhancing information systems, and expanding existing office space. During fiscal 1997, the Company made equity investments of $27.3 million in its joint venture with Pepsi-Cola Company and $0.9 million in its joint venture with SAZABY, Inc to develop Starbucks retail stores in Japan. The Company's joint venture with Dreyer's Grand Ice Cream, Inc. repaid advances of $0.6 million to the Company. The Company invested excess cash primarily in short-term investment-grade marketable debt securities.

Cash provided by financing activities for fiscal 1997 totaled $29.9 million and included cash generated from the exercise of employee stock options and the related income tax benefit available to the Company upon exercise of such options and cash generated from the Company's employee stock purchase plan. As options granted under the Company's stock option plans vest, the Company will continue to receive proceeds and a tax deduction as a result of option exercises; however, neither the amounts nor the timing thereof can be predicted.

Cash requirements for fiscal 1998, other than normal operating expenses, are expected to consist primarily of capital expenditures related to the addition of new Company-operated retail stores. The Company and its licensees plan to open at least 350 new stores in continental North America during fiscal 1998. The Company also anticipates incurring additional expenditures for enhancing its production capacity and information systems and remodeling certain existing stores. While there can be no assurance that current expectations will be realized, management expects capital expenditures for fiscal 1998 to be approximately $200 million. Longer term, the Company expects to reach its goal of 2000 stores in continental North America by the year 2000 using cash flow generated from operations supplemented by additional debt or equity financing, if necessary.

Management currently anticipates additional cash requirements of approximately $10 million for its domestic joint ventures and international expansion during fiscal 1998. In addition, under the terms of the Company's corporate office lease, the Company provides financing to the building owner to be used exclusively for facilities and leasehold development costs to accommodate the Company. Any funds advanced by the Company are repaid with interest over a term not to exceed 20 years. During fiscal 1997, the Company provided approximately $3.6 million under this agreement. As of September 28, 1997, the total amount provided to date was $8.2 million. During fiscal 1998, the Company intends to provide additional funds of approximately $2 million under this agreement. The maximum amount available under the agreement is $17 million.

Management believes that existing cash and investments plus cash generated from operations should be sufficient to finance capital requirements for its core businesses through fiscal 1998. Any new joint ventures, other new business opportunities, or store expansion rates substantially in excess of that presently planned may require outside funding.

## YEAR 2000 COMPLIANCE

The Company has evaluated the costs necessary to make its computer systems Year 2000 compliant. The bulk of these costs are expected to be incurred during fiscal 1998 and are not expected to have a material impact on the Company's cash flows, results of operations or financial condition.

## COFFEE PRICES, AVAILABILITY AND GENERAL RISK CONDITIONS

Green coffee commodity prices are subject to substantial price fluctuations, generally caused by multiple factors including weather, political and economic conditions in certain coffee-producing countries and other supply-related matters. In addition, green coffee prices have been affected in the past, and may be affected in the future, by the actions of certain organizations and associations, such as the International Coffee Organization and the Association of Coffee Producing Countries, which have historically attempted to influence commodity prices of green coffee through agreements establishing export quotas or restricting coffee supplies worldwide. During fiscal 1997, worldwide green coffee commodity prices increased significantly and remain high relative to historical levels.In response, the Company effected sales price increases on its whole bean coffees and its coffee beverages to mitigate the effects of anticipated increases in its costs of supply. The Company's margins were favorably impacted by these sales price increases during most of the second half of fiscal 1997 because the Company had existing inventories and fixed price purchase commitments for some of its supply of green coffees. During the fourth quarter of fiscal 1997, cost of goods began reflecting the higher cost coffees purchased since the sustained rise in coffee costs. Management believes the Company's gross margins may experience compression in fiscal 1998 due to these higher cost coffees.

The Company enters into fixed price purchase commitments in order to secure an adequate supply of quality green coffee and fix costs for future periods. As of September 28, 1997 the Company had approximately $54 million in fixed price purchase commitments which, together with existing inventory, is expected to provide an adequate supply of green coffee well into fiscal 1998. The Company believes, based on relationships established with its suppliers in the past, that the risk of non-delivery on such purchase commitments is remote.

Although green coffee commodity prices are lower than the highs reached during mid-fiscal 1997, they are still high relative to historical levels. If coffee commodity prices remain at their current levels, the Company will continue to incur substantially higher costs for the specialty coffees it purchases compared to fiscal 1997. The Company's ability to raise sales prices in response to rising coffee prices may be limited.

In addition to fluctuating coffee prices, management believes that the Company's future results of operations and earnings could be significantly impacted by other factors such as increased competition within the specialty coffee industry, the Company's ability to find optimal store locations at favorable lease rates, the increased costs associated with opening and operating retail stores in new markets, the Company's continued ability to hire, train, and retain qualified personnel, and the Company's ability to obtain adequate capital to finance its planned expansion.

## FINANCIAL RISK MANAGEMENT

The Company maintains investment portfolio holdings of various issuers, types, and maturities. These securities are classified as available-for-sale, and are recorded on the balance sheet at fair value with unrealized gains or losses reported as a separate component of retained earnings. As of September 28, 1997, approximately 93% of the total portfolio was invested in short-term marketable debt securities with maturities less than one year. An additional 6% was invested in long-term marketable debt securities with maturities of 12 to 18 months, and the remaining 1% was invested in marketable equity securities. The Company does not hedge its interest rate exposures. Based on the current portfolio, a 100 basis point move in the Federal Funds Rate, which has occurred in only three of the past 40 quarters, would not have a material impact on the Company's financial condition.

The Company has retail operations in Canada and is, therefore, subject to foreign currency exchange rate exposure. Historically, the exchange rate volatility and related exposure to the Company has been minimal. At the present time, the Company does not hedge foreign currency risk, but management is currently evaluating a foreign exchange hedging strategy.

## SEASONALITY AND QUARTERLY RESULTS

The Company's business is subject to seasonal fluctuations. Significant portions of the Company's net revenues and profits are realized during the first quarter of the Company's fiscal year, which includes the December holiday season. In addition, quarterly results are affected by the timing of the opening of new stores, and the Company's rapid growth may conceal the impact of other seasonal influences. Because of the seasonality of the Company's business, results for any quarter are not necessarily indicative of the results that may be achieved for the full fiscal year.

## NEW ACCOUNTING STANDARDS

In February 1997, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) 128, "Earnings Per Share." This pronouncement establishes new standards for the computation, presentation and disclosure requirements for earnings per share (EPS). SFAS 128 is effective for periods ending after December 15, 1997 and requires restatement of all prior period EPS data presented. The Company is required to adopt SFAS 128 in its first quarter of fiscal 1998. If the provisions of SFAS 128 had been used to calculate EPS for the 1997, 1996, and 1995 fiscal years, pro forma EPS would have been as follows:

Pro forma earnings per share under SFAS 128:

| | Sept 28, 1997 (52 Weeks) | Sept 29, 1996 (52 Weeks) | Oct 1, 1995 (52 Weeks) |
|---|---|---|---|
| Basic Earnings per share | $ 0.73 | $ 0.57 | $ 0.38 |
| Diluted Earnings per share | $ 0.70 | $ 0.54 | $ 0.37 |

In June 1997, the FASB issued SFAS 130 "Reporting Comprehensive Income," which establishes standards for reporting and displaying comprehensive income and its components (revenue, expenses, gains, and losses) in a full set of general-purpose financial statements. The Company will adopt SFAS 130 in fiscal 1999.

In June 1997, the FASB issued SFAS 131 "Disclosures about Segments of an Enterprise and Related Information," which changes the way public companies report information about operating segments. The Company will adopt SFAS 131 in fiscal 1999. This statement, which is based on the management approach to segment reporting, establishes requirements to report selected segment information quarterly and to report entity-wide disclosures about products and services, major customers, and the major countries in which the company holds assets and reports revenues.

Management believes that the adoption of these new standards will not have a material impact on the Company's financial position or results of operations.

## CONSOLIDATED BALANCE SHEETS

(in thousands, except share data)

| | Sept 28, 1997 | Sept 29, 1996 |
|---|---|---|
| Assets | | |
| Current Assets: | | |
| Cash and cash equivalents | $ 70,126 | $126,215 |
| Short-term investments | 83,504 | 103,221 |
| Accounts and notes receivable | 30,524 | 17,621 |
| Inventories | 119,526 | 83,370 |
| Prepaid expenses and other current assets | 8,763 | 6,534 |
| Deferred income taxes, net | 4,164 | 2,580 |
| Total current assets | 316,607 | 339,541 |
| Joint ventures and other investments | 34,464 | 4,401 |
| Property, plant, and equipment, net | 483,259 | 369,477 |
| Deposits and other assets | 16,342 | 13,194 |
| Total | $850,672 | $726,613 |
| Liabilities and Shareholders' Equity | | |
| Current Liabilities: | | |
| Accounts payable | $ 46,324 | $ 38,034 |
| Checks drawn in excess of bank balances | 25,807 | 16,241 |
| Accrued compensation and related costs | 25,894 | 15,001 |
| Accrued interest payable | 2,927 | 3,004 |
| Accrued occupancy costs | 12,184 | 7,976 |
| Other accrued expenses | 25,893 | 20,835 |
| Total current liabilities | 139,029 | 101,091 |
| Deferred income taxes, net | 12,784 | 7,114 |
| Capital lease obligations | 2,009 | 1,728 |
| Convertible subordinated debentures | 165,020 | 165,020 |
| Commitments and contingencies (notes 4, 5, 8, and 12) | | |
| Shareholders' Equity: | | |
| Common stock--Authorized, 150,000,000 shares; issued and outstanding, 79,058,754 and 77,583,868 shares | 386,877 | 361,309 |
| Retained earnings, including cumulative translation adjustment of $(1,603) and $(776) respectively, and net unrealized holding gain on investments of $63 and $2,046, respectively | 144,953 | 90,351 |
| Total shareholders' equity | 531,830 | 451,660 |
| Total | $850,672 | $726,613 |

# CONSOLIDATED STATEMENTS OF EARNINGS

(in thousands, except earnings per share)

| Fiscal year ended: | Sept 28, 1997 | Sept 29, 1996 | Oct 1, 1995 |
|---|---|---|---|
| Net revenues | $ 966,946 | $ 696,481 | $ 465,213 |
| Cost of sales and related occupancy costs | 432,190 | 335,800 | 211,279 |
| Store operating expenses | 309,133 | 210,693 | 148,757 |
| Other operating expenses | 28,116 | 19,787 | 13,932 |
| Depreciation and amortization | 52,141 | 35,950 | 22,486 |
| General and administrative expenses | 57,144 | 37,258 | 28,643 |
| Operating income | 88,222 | 56,993 | 40,116 |
| Interest and other income | 12,393 | 11,029 | 6,792 |
| Interest expense | (7,266) | (8,739) | (3,765) |
| Gain on sale of investment in Noah's | -- | 9,218 | -- |
| Earnings before income taxes | 93,349 | 68,501 | 43,143 |
| Income taxes | 35,937 | 26,373 | 17,041 |
| Net earnings | $ 57,412 | $ 42,128 | $ 26,102 |
| Net earnings per common and common equivalent share - primary | $ 0.70 | $ 0.55 | $ 0.37 |
| Net earnings per common and common equivalent share - fully diluted | $ 0.70 | $ 0.54 | $ 0.36 |
| Weighted average shares outstanding: | | | |
| Primary | 81,638 | 76,964 | 71,309 |
| Fully diluted | 89,231 | 80,831 | 71,909 |

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

| Fiscal year ended: | Sept 28, 1997 | Sept 29, 1996 | Oct 1, 1995 |
|---|---|---|---|
| Operating Activities: | | | |
| Net earnings | $ 57,412 | $ 42,128 | $ 26,102 |
| Adjustments to reconcile net earnings to net cash provided by operating activities: | | | |
| Depreciation and amortization | 58,203 | 39,370 | 24,827 |
| Provision for store remodels and asset disposals | 1,049 | 412 | 2,745 |
| Deferred income taxes, net | 5,328 | 4,407 | 84 |
| Equity in losses of investees | 2,760 | 1,935 | 1,156 |
| Gain on sale of investment in Noah's | -- | (9,218) | -- |
| Cash (used) provided by changes in operating assets and liabilities: | | | |
| Accounts and notes receivable | (12,907) | (7,771) | (4,456) |
| Inventories | (36,185) | 40,274 | (67,579) |
| Prepaid expenses and other current assets | (2,236) | (1,769) | 519 |
| Accounts payable | 8,113 | 9,291 | 19,590 |
| Accrued compensation and related costs | 10,871 | 2,208 | 3,717 |
| Accrued interest payable | (77) | 3,207 | 24 |
| Accrued occupancy costs | 4,208 | 3,345 | 2,353 |
| Other accrued expenses | 4,452 | 8,860 | 3,469 |
| Net cash provided by operating activities | 100,991 | 136,679 | 12,551 |
| Investing Activities: | | | |
| Purchase of investments | (171,631) | (178,643) | (136,256) |
| Sale of investments | 9,257 | 17,144 | 27,702 |
| Maturity of investments | 173,665 | 103,056 | 74,808 |
| Investments in joint ventures and other investments | (27,624) | (6,040) | (12,484) |
| Proceeds from sale of equity investments | -- | 20,550 | -- |
| Additions to property, plant, and equipment | (169,667) | (161,814) | (129,386) |
| Additions to deposits and other assets | (1,004) | (1,132) | (854) |
| Net cash used by investing activities | (187,004) | (206,879) | (176,470) |
| Financing Activities: | | | |
| Increase in cash provided by checks drawn in excess of bank balances | 9,543 | 3,096 | 1,180 |
| Proceeds from sale of convertible debentures | -- | 165,020 | -- |
| Debt issuance costs | -- | (4,045) | -- |
| Proceeds from notes payable | -- | -- | 19,000 |
| Principal repayments of notes payable | -- | -- | (19,000) |
| Net proceeds from sale of common stock | -- | -- | 163,873 |
| Proceeds from sale of common stock under employee stock purchase plan | 2,313 | 1,735 | 263 |
| Exercise of stock options and warrants | 13,629 | 8,032 | 3,157 |
| Tax benefit from exercise of nonqualified stock options | 9,626 | 6,808 | 4,754 |
| Payments received on subscription notes receivable | -- | -- | 3,671 |
| Payments on capital lease obligations | (1,566) | (575) | (147) |
| Debt conversion costs | -- | (290) | -- |
| Advances to landlord | (3,600) | (4,300) | (300) |
| Net cash provided by financing activities | 29,945 | 175,481 | 176,451 |
| Effect of exchange rate changes on cash and cash equivalents | (21) | (10) | 18 |
| (Decrease) increase in cash and cash equivalents | (56,089) | 105,271 | 12,550 |
| Cash and Cash Equivalents: | | | |
| Beginning of year | 126,215 | 20,944 | 8,394 |
| End of year | $ 70,126 | $ 126,215 | $ 20,944 |

| | | | |
|---|---|---|---|
| Supplemental Disclosure of Cash Flow Information: | | | |
| Cash paid during the year for: | | | |
| Interest | $ 7,111 | $ 5,630 | $ 3,738 |
| Income taxes | 19,679 | 12,127 | 10,761 |
| Noncash Financing and Investing Transactions: | | | |
| Equipment acquired under capital lease | $ 2,434 | $ 2,089 | $ 1,522 |
| Net unrealized holding (losses) gains on investments | (1,983) | 2,012 | 141 |
| Conversion of convertible debt into common stock, net of unamortized issue costs | -- | 79,345 | 100 |

## CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(in thousands, except share data)

| | Common stock Shares | Common stock Amount | Retained earnings | Total |
|---|---|---|---|---|
| Balance, October 2, 1994 | 57,936,988 | $ 89,861 | $ 20,037 | $ 109,898 |
| Exercise of stock options including tax benefit of $4,754 | 945,780 | 7,911 | -- | 7,911 |
| Sale of common stock | 12,050,000 | 163,873 | -- | 163,873 |
| Payments received on stock subscription notes | -- | 3,671 | -- | 3,671 |
| Conversions of convertible debt into common stock | 6,798 | 100 | -- | 100 |
| Sale of common stock under employee stock purchase plan | 17,424 | 263 | -- | 263 |
| Net earnings | -- | -- | 26,102 | 26,102 |
| Unrealized holding gains, net | -- | -- | 141 | 141 |
| Translation adjustment | -- | -- | 272 | 272 |
| Balance, October 1, 1995 | 70,956,990 | 265,679 | 46,552 | 312,231 |
| Exercise of stock options including tax benefit of $6,808 | 1,177,736 | 14,840 | -- | 14,840 |
| Conversions of convertible debt into common stock | 5,359,769 | 79,055 | -- | 79,055 |
| Sale of common stock under employee stock purchase plan | 89,373 | 1,735 | -- | 1,735 |
| Net earnings | -- | -- | 42,128 | 42,128 |
| Unrealized holding gains, net | -- | -- | 2,012 | 2,012 |
| Translation adjustment | -- | -- | (341) | (341) |
| Balance, September 29, 1996 | 77,583,868 | 361,309 | 90,351 | 451,660 |
| Exercise of stock options including tax benefit of $9,626 | 1,381,915 | 23,255 | -- | 23,255 |
| Sale of common stock under employee stock purchase plan | 92,971 | 2,313 | -- | 2,313 |
| Net earnings | -- | -- | 57,412 | 57,412 |
| Unrealized holding losses, net | -- | -- | (1,983) | (1,983) |
| Translation adjustment | -- | -- | (827) | (827) |
| Balance, September 28, 1997 | 79,058,754 | $ 386,877 | $ 144,953 | $ 531,830 |

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(years ended September 28, 1997, September 29, 1996, and October 1, 1995)

### NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of Business Starbucks Corporation and its subsidiaries ("Starbucks" or the "Company") purchase and roast high-quality whole bean coffees and sell them, along with a variety of coffee beverages, pastries, confections, and coffee-related accessories and equipment, primarily through Company-operated and licensed retail stores located throughout the United States and in parts of Canada and the Pacific Rim. In addition to sales through its Company-owned retail stores, the Company sells primarily whole bean coffees through a specialty sales group and a direct response business. Starbucks, through its joint venture partnerships, also produces and sells bottled Frappuccino(TM) coffee drink and a line of premium coffee ice creams.

Basis of Presentation The consolidated financial statements include the accounts of Starbucks Corporation and its wholly owned subsidiaries. Investments in unconsolidated joint ventures are accounted for under the equity method. Material intercompany transactions during the periods covered by these consolidated financial statements have been eliminated.

Fiscal Year End The Company's fiscal year ends on the Sunday closest to September 30. Fiscal years 1997, 1996, and 1995 each had 52 weeks.

Estimates and Assumptions The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, and expenses. Actual results may differ from these estimates.

Cash and Cash Equivalents The Company considers all highly liquid instruments with a maturity of three months or less at the time of purchase to be cash equivalents.

Cash Management The Company's cash management system provides for the reimbursement of all major bank disbursement accounts on a daily basis. Checks issued but not presented for payment to the bank are reflected as "Checks drawn in excess of bank balances" in the accompanying financial statements.

Investments The Company's investments consist primarily of investment-grade marketable debt securities, all of which are classified as available-for-sale and recorded at fair value as defined below. Unrealized holding gains and losses are recorded, net of any tax effect, as a component of retained earnings.

Fair Value of Financial Instruments The carrying value of cash and cash equivalents approximates fair value because of the short-term maturity of those instruments. The fair value of the Company's investments in marketable debt and equity securities is based upon the quoted market price on the last business day of the fiscal year plus accrued interest, if any. The fair value and amortized cost of the Company's investments (short- and long-term) at September 28, 1997, were $88.7 million and $88.6 million, respectively. The fair value and amortized cost of the Company's short-term investments at September 29, 1996, were $103.2 million and $99.9 million, respectively. For further detail on investments, see Note 3. The fair value of the Company's 4 1/4% Convertible Subordinated Debentures due 2002 (see Note 7) is based on the quoted market price on the last business day of the fiscal year. As of September 28, 1997, the fair value and principal amount of the 4 1/4% Convertible Subordinated Debentures due 2002 were $294.6 million and $165.0 million, respectively. The fair value and principal amount of these Debentures at September 29, 1996, were $248.0 million and $165.0 million, respectively.

Inventories Inventories are stated at the lower of cost (primarily moving average cost) or market.

Property, Plant, and Equipment Property, plant, and equipment are carried at cost less accumulated depreciation and amortization. Depreciation of property, plant, and equipment, which includes amortization of assets under capital leases, is provided on the straight-line method over estimated useful lives, generally ranging from three to seven years for equipment and 40 years for buildings. Leasehold improvements are amortized over the shorter of their estimated useful lives or the related lease life, generally ten years. The portion of depreciation expense related to production and distribution facilities is included in "Cost of sales and related occupancy costs". When facts and circumstances indicate that the cost of long-lived assets may be impaired, an evaluation of recoverability is performed by comparing the carrying value of the asset to projected future cash flows. Upon indication that the carrying value of such assets may not be recoverable, the Company recognizes an impairment loss by a charge against current operations.

Hedging and Futures Contracts The Company may, from time to time, enter into futures contracts to hedge price-to-be-established coffee purchase commitments with the objective of minimizing cost risk due to market fluctuations. The Company did not purchase or sell futures contracts during fiscal 1997, 1996, or 1995.

Advertising The Company expenses costs of advertising the first time the advertising campaign takes place, except for direct response advertising, which is capitalized and amortized over its expected period of future benefit. Direct response advertising consists primarily of mail order catalog costs and customer retention program costs. Catalog costs are amortized over the period from the catalog mailing until the issuance of the next catalog, typically three months. Customer retention program costs are amortized over six months.

Store Preopening Expenses Costs incurred in connection with start-up and promotion of new store openings are expensed as incurred.

Rent Expense Certain of the Company's lease agreements provide for scheduled rent increases during the lease terms, or for rental payments commencing at a date other than the date of initial occupancy. Rent expenses are recognized on a straight-line basis over the terms of the leases.

Foreign Currency Translation The accumulated foreign currency translation relates to the Company's operations in Canada. Assets and liabilities are translated at exchange rates in effect at the balance sheet date and income and expense accounts at the average exchange rates during the year. Resulting translation adjustments are recorded directly to a separate component of retained earnings.

Income Taxes The Company computes income taxes using the asset and liability method, under which deferred income taxes are provided for the temporary differences between the financial reporting basis and the tax basis of the Company's assets and liabilities.

Earnings per Share The computation of primary earnings per share is based on the weighted average number of shares outstanding during the period plus dilutive common stock equivalents consisting primarily of certain shares subject to stock options. The numbers of shares resulting from this computation for fiscal 1997, 1996, and 1995 were 81.6 million, 77.0 million, and 71.3 million, respectively.

The computation of fully diluted earnings per share assumes conversion of the Company's convertible subordinated debentures using the "if converted" method, when such securities are dilutive, with net income adjusted for the after-tax interest expense and amortization applicable to these debentures. The numbers of shares resulting from this computation for fiscal 1997, 1996, and 1995 were 89.2 million, 80.8 million, and 71.9 million, respectively.

Recent Accounting Pronouncements In February 1997, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") 128, "Earnings Per Share." This pronouncement establishes new standards for the computation, presentation and disclosure requirements for earnings per share ("EPS"). SFAS 128 is effective for periods ending after December 15, 1997 and requires restatement of all prior period EPS data presented. The Company is required to adopt SFAS 128 in its first quarter of fiscal 1998. If the provisions of SFAS 128 had been used to calculate EPS for the 1997, 1996, and 1995 fiscal years, pro forma EPS would have been as follows:

| Pro forma earnings per share under SFAS 128: | Sept 28, 1997 (52 Weeks) | Sept 29, 1996 (52 Weeks) | Oct 1, 1995 (52 Weeks) |
|---|---|---|---|
| Basic Earnings per share | $ 0.73 | $ 0.57 | $ 0.38 |
| Diluted Earnings per share | $ 0.70 | $ 0.54 | $ 0.37 |

In June 1997, the FASB issued SFAS 130 "Reporting Comprehensive Income," which establishes standards for reporting and displaying comprehensive income and its components (revenue, expenses, gains, and losses) in a full set of general-purpose financial statements. The Company will adopt SFAS 130 in fiscal 1999.

In June 1997, the FASB issued SFAS 131 "Disclosures about Segments of an Enterprise and Related Information," which changes the way public companies report information about operating segments. The Company will adopt SFAS 131 in fiscal 1999. This statement, which is based on the management approach to segment reporting, establishes requirements to report selected segment information quarterly and to report entity-wide disclosures about products and services, major customers, and the major countries in which the Company holds assets and reports revenues.

Management believes that the adoption of these new standards will not have a material impact on the Company's financial position or results of operations.

Reclassifications Certain reclassifications of prior years' balances have been made to conform to the fiscal 1997 presentation.

**NOTE 2: CASH AND CASH EQUIVALENTS**

Cash and cash equivalents consist of the following (in thousands):

| | Sept 28, 1997 | Sept 29, 1996 |
|---|---|---|
| Operating funds and interest-bearing deposits | $ 14,482 | $ 11,069 |
| Commercial paper | 39,649 | 93,306 |
| Money market funds | 8,152 | 14,590 |
| Local government obligations | 4,022 | 7,250 |
| Corporate debt securities | 3,821 | -- |
| | $ 70,126 | $126,215 |

**NOTE 3: INVESTMENTS**

The company's investments, including aggregate fair values, cost, gross unrealized holding gains, and gross unrealized holding losses, consist of the following (in thousands):

| September 28, 1997 | Fair value | Amortized cost | Gross unrealized holding gains | Gross unrealized holding losses |
|---|---|---|---|---|
| Current investments: | | | | |
| Corporate debt securities | $25,948 | $25,944 | $ 10 | $ (6) |
| U.S. Government obligations | 30,532 | 30,540 | 8 | (16) |
| Commercial paper | 25,720 | 25,721 | -- | (1) |
| Marketable equity securities | 1,304 | 1,198 | 106 | -- |
| | $83,504 | $83,403 | $ 124 | (23) |
| Non-current investments: | | | | |
| Corporate debt securities | $ 4,196 | $ 4,194 | $ 2 | $-- |
| US. Government obligations | 1,005 | 1,006 | -- | (1) |
| | $ 5,201 | $ 5,200 | $ 2 | $ (1) |

| September 29, 1996 | Fair value | Amortized cost | Gross unrealized holding gains | Gross unrealized holding losses |
|---|---|---|---|---|
| Current investments: | | | | |
| Corporate debt securities | $33,112 | $33,118 | $ 11 | $ (17) |
| U.S. Government obligations | 45,041 | 45,017 | 36 | (12) |
| Commercial paper | 19,958 | 19,959 | -- | (1) |
| Marketable equity securities | 5,110 | 1,800 | 3,310 | -- |
| | $103,221 | $99,894 | $ 3,357 | $ (30) |

All investments are classified as available-for-sale as of September 28, 1997 and September 29, 1996. Securities with remaining maturity dates of one year or less are classified as short-term investments. Securities with remaining maturity dates beyond one year are classified as long-term and are included in the line item "Joint ventures and other investments" in the accompanying balance sheets. The specific identification method is used to determine a cost basis for computing realized gains and losses.

During fiscal 1995, the Company invested $11.3 million in cash for shares of Noah's New York Bagel, Inc. ("Noah's") Series B Preferred Stock. On February 1, 1996, Noah's merged with Einstein Brothers Bagels, Inc. In exchange for its investment in Noah's, the Company received $20.6 million in cash and recognized a $9.2 million pre-tax gain ($5.7 million net of tax) on the transaction.

In fiscal 1997, 1996, and 1995, proceeds from the sale of investment securities were $9.3 million, $17.1 million, and $27.7 million, respectively. Gross realized gains and losses were not material in 1997, 1996, and 1995 except for the sale of Noah's stock, which occurred in fiscal 1996.

**NOTE 4: INVENTORIES**

Inventories consist of the following (in thousands):

| | Sept 28, 1997 | Sept 29, 1996 |
|---|---|---|
| Coffee | | |
| Unroasted | $ 65,197 | $ 37,127 |
| Roasted | 13,932 | 9,753 |
| Other merchandise held for sale | 33,168 | 29,518 |
| Packaging and other supplies | 7,229 | 6,972 |
| | $119,526 | $ 83,370 |

As of September 28, 1997, the Company had fixed price inventory purchase commitments for green coffee totaling approximately $54 million. The Company believes, based on relationships established with its suppliers in the past, that the risk of non-delivery on such purchase commitments is remote.

**NOTE 5: JOINT VENTURES AND OTHER INVESTMENTS**

Joint Ventures Starbucks has entered into several joint ventures, all of which are accounted for using the equity method. The Company's share of joint venture income or losses is included in "Other operating expenses."

The Company has domestic joint ventures with two companies to produce and distribute Starbucks branded coffee-related products. During fiscal 1994, the Company entered into a 50/50 joint venture and partnership agreement (the "Partnership Agreement") with Pepsi-Cola Company ("Pepsi") to develop ready-to-drink coffee-based beverages. During fiscal 1996, the Company modified the Partnership Agreement to revise the allocation of start-up risks and expenses between partners. Also during fiscal 1996, the Company entered into a 50/50 joint venture agreement with Dreyer's Grand Ice Cream, Inc. to develop and distribute premium coffee ice creams.

The Company is a partner in two other joint ventures. During fiscal 1996, the Company signed an agreement with SAZABY Inc., a Japanese retailer and restaurateur, to form a joint venture partnership (50/50) to develop Starbucks retail stores in Japan. On August 3, 1996, the Company entered into a joint venture partnership as a 5% partner with Cafe Partners Hawaii to develop Starbucks retail stores in Hawaii.

The Company's investments in and losses from these joint ventures are as follows (in thousands):

| | Pepsi joint venture | All other joint ventures | Total |
|---|---|---|---|
| Balance, October 2, 1994 | $ 300 | $ -- | $ 300 |
| Allocated share of losses | (1,156) | -- | (1,156) |
| Capital contributions | 1,150 | -- | 1,150 |
| Balance, October 1, 1995 | 294 | -- | 294 |
| Allocated share of losses | (401) | (1,534) | (1,935) |
| Capital contributions | 2,725 | 3,315 | 6,040 |
| Balance, September 29, 1996 | 2,618 | 1,781 | 4,399 |
| Allocated share of losses | (2,384) | (376) | (2,760) |
| Capital contributions | 27,259 | 365 | 27,624 |
| Balance, September 28, 1997 | $ 27,493 | $ 1,770 | $ 29,263 |

## NOTE 6: PROPERTY, PLANT, AND EQUIPMENT

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

| | Sept 28, 1997 | Sept 29, 1996 |
|---|---|---|
| Land | $ 3,602 | $ 3,602 |
| Building | 8,338 | 8,338 |
| Leasehold improvements | 350,173 | 255,567 |
| Roasting and store equipment | 167,547 | 120,575 |
| Furniture, fixtures, and other | 47,378 | 38,794 |
| | 577,038 | 426,876 |
| Less accumulated depreciation and amortization | (143,339) | (88,003) |
| | 433,699 | 338,873 |
| Work in progress | 49,560 | 30,604 |
| | $ 483,259 | $ 369,477 |

## NOTE 7: CONVERTIBLE SUBORDINATED DEBENTURES

During fiscal 1993, the Company issued $80.5 million in principal amount of 4 1/2% Convertible Subordinated Debentures Due 2003. On April 12, 1996, the Company called these debentures for redemption. The total principal amount converted, net of unamortized issue costs, accrued but unpaid interest, and costs of conversion was credited to common stock.

During the first quarter of fiscal 1996, the Company issued approximately $165.0 million in principal amount of 4 1/4% Convertible Subordinated Debentures Due 2002 (the "Debentures"). Net proceeds to the Company were approximately $161.0 million. Interest was payable on May 1 and November 1 of each year. The Debentures were convertible into common stock of the Company at a price of $23.25, subject to adjustment under certain conditions, and were redeemable on or after November 10, 1997 at the option of the Company, at specified redemption prices and subject to certain conditions. Costs incurred in connection with the issuance of the Debentures were included in "Deposits and other assets" and were amortized on a straight-line basis over the seven-year period to maturity.

On October 21, 1997, the Company called the Debentures for redemption. Substantially all of these Debentures were converted into approximately 7.1 million shares of the Company's common stock prior to the redemption date.

**NOTE 8: LEASES**

The Company leases retail stores, roasting and distribution facilities, and office space under operating leases expiring through 2015. Most lease agreements contain renewal options and rent escalation clauses. Certain leases provide for contingent rentals based upon gross sales. The Company also leases certain computer equipment and software under agreements classified as capital leases with original lease terms ranging from two to four years.

Rental expense under these lease agreements was as follows (in thousands):

| Fiscal year ended: | Sept 28, 1997 | Sept 29, 1996 | Oct 1, 1995 |
|---|---|---|---|
| Minimum rentals | $52,919 | $37,527 | $21,590 |
| Contingent rentals | 1,193 | 1,190 | 1,088 |
| | $54,112 | $38,717 | $22,678 |

Minimum future rental payments under non-cancelable lease obligations as of September 28, 1997 are as follows (in thousands):

| Fiscal year ending: | Capital Leases | Operating Leases |
|---|---|---|
| 1998 | $ 2,155 | $ 52,845 |
| 1999 | 1,543 | 53,179 |
| 2000 | 783 | 53,420 |
| 2001 | -- | 53,787 |
| 2002 | -- | 53,705 |
| Thereafter | -- | 205,525 |
| Total minimum lease payments | $ 4,481 | $472,461 |
| Less: Amounts representing interest and other expenses | (669) | |
| Present value of net minimum lease payments | 3,812 | |
| Less: Current portion | (1,803) | |
| Long-term capital lease obligations | $ 2,009 | |

Assets recorded under capital leases are included in "Property, plant, and equipment" within the "Furniture, fixtures, and other" category. Assets recorded under capital leases, net of accumulated amortization, totaled $3.9 million and $3.6 million at September 28, 1997, and September 29, 1996, respectively.

The Company opened a roasting and distribution facility in York County, Pennsylvania in September 1995 (the "York Plant"). Under the terms of this lease agreement, the Company has an option to purchase the land and building comprising the York Plant for approximately $14 million within five years of the date of occupancy. Such option to purchase also provides that the Company may purchase, within seven years of occupancy, additional land adjacent to the York Plant.

**NOTE 9: SHAREHOLDERS' EQUITY**

In November 1994, the Company completed a public offering of 12,050,000 shares of newly issued common stock for proceeds of approximately $163.9 million, net of expenses.

On February 28, 1996, the Company's shareholders approved an amendment to the Company's articles of incorporation increasing the number of authorized common shares from 100,000,000 to 150,000,000.

The Company's common stock was split two-for-one on December 1, 1995. All applicable share and per-share data in these consolidated financial statements have been restated to give effect to this stock split.

The Company has authorized 7,500,000 shares of its preferred stock, none of which is outstanding at September 28, 1997.

**NOTE 10: EMPLOYEE BENEFIT PLANS**

The Company maintains several stock option plans under which the Company may grant incentive stock options and nonqualified stock options to employees and non-employee directors. Stock options have been granted at prices at or above the fair market value on the date of grant. Options vest and expire according to terms established at the grant date.

The following summarizes all stock option transactions from October 2, 1994, through September 28, 1997.

| | Shares | Weighted average price per share |
|---|---|---|
| Outstanding, October 2, 1994 | 6,117,966 | $ 6.61 |
| Granted | 2,853,476 | 13.19 |
| Exercised | (945,780) | 3.34 |
| Cancelled | (1,151,006) | 10.12 |
| Outstanding, October 1, 1995 | 6,874,656 | 9.52 |
| Granted | 2,394,617 | 19.72 |
| Exercised | (1,177,736) | 6.78 |
| Cancelled | (449,158) | 13.99 |
| Outstanding, September 29, 1996 | 7,642,379 | 12.92 |
| Granted | 2,782,295 | 34.26 |
| Exercised | (1,382,443) | 9.92 |
| Cancelled | (379,920) | 21.30 |
| Outstanding, September 28. 1997 | 8,662,311 | $ 19.72 |
| Exercisable, September 28, 1997 | 3,503,676 | $ 11.49 |

At September 29, 1996, 3,316,967 outstanding options were exercisable at the weighted average exercise price of $8.43. At October 1, 1995, 3,108,578 outstanding options were exercisable at the weighted average exercise price of $6.36.

At September 28, 1997, there were 10,640,907 shares of common stock reserved for issuance pursuant to future stock option grants.

Additional information regarding options outstanding as of September 28, 1997 is as follows:

| Range of Exercise Prices | | Options Outstanding: Shares | Options Outstanding: Weighted Average Remaining Contractual Life (Years) | Options Outstanding: Weighted Average Exercise Price | Options Exercisable: Shares | Options Exercisable: Weighted Average Exercise Price |
|---|---|---|---|---|---|---|
| $ 0.75 | $ 8.91 | 1,458,791 | 2.61 | $ 5.69 | 1,440,024 | $ 5.68 |
| 10.28 | 14.56 | 2,344,737 | 6.77 | 12.44 | 1,355,532 | 12.44 |
| 15.00 | 18.81 | 1,564,803 | 8.02 | 18.43 | 383,811 | 18.15 |
| 19.38 | 32.50 | 926,701 | 8.35 | 24.35 | 305,213 | 24.91 |
| 33.00 | 43.50 | 2,367,279 | 9.16 | 34.62 | 19,096 | 34.58 |
| $ 0.75 | $ 43.50 | 8,662,311 | 7.12 | $ 19.72 | 3,503,676 | $ 11.49 |

Employee Stock Purchase Plan During fiscal 1995, the Company implemented an employee stock purchase plan. The Company's plan provides that eligible employees may contribute up to 10% of their base earnings toward the quarterly purchase of the Company's common stock up to $25,000 of common stock. The employee's purchase price is 85% of the lesser of the fair market value of the stock on the first business day or the last business day of the quarterly offering period. No compensation expense is recorded in connection with the plan. The total number of shares issuable under the plan is 4,000,000. There were 92,971 shares issued under the plan during fiscal 1997 at prices ranging from $23.59 to $25.71. There were 89,373 shares issued under the plan during fiscal 1996 at prices ranging from $15.99 to $24.65. There were 17,424 shares issued under the plan during fiscal 1995 at a price of $15.09. Of the 14,583 employees eligible to participate, 2,549 were participants in the plan as of September 28, 1997.

Accounting For Stock-Based Compensation The Company accounts for its stock-based awards using the intrinsic value method in accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" and its related interpretations. Accordingly, no compensation expense has been recognized in the financial statements for employee stock arrangements.

Statement of Financial Accounting Standards 123, "Accounting for Stock-Based Compensation," ("SFAS 123") requires the disclosure of pro forma net income (loss) and net income (loss) per share as if the Company adopted the fair value method as of the beginning of fiscal 1996. The fair value of stock-based awards to employees is calculated using the Black-Scholes option pricing model with the following weighted average assumptions:

| | Employee Stock Options: 1997 | Employee Stock Options: 1996 | Employee Stock Purchase Plan: 1997 | Employee Stock Purchase Plan: 1996 |
|---|---|---|---|---|
| Expected life (years) | 1.5 - 6 | 1.5 - 6 | .25 | .25 |
| Expected volatility | 40% | 40% | 45 - 47% | 39-61% |
| Risk-free interest rate | 5.41 - 6.54% | 5.01 - 6.74% | 5.27 - 5.53% | 5.27 - 5.49% |
| Expected dividend yield | 0.0% | 0.0% | 0.0% | 0.0% |

The Company's valuations are based upon a multiple option valuation approach and forfeitures are recognized as they occur. The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options, which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company's employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options.

As required by SFAS 123, the Company has determined that the weighted average estimated fair values of options granted during fiscal 1997 and 1996 were $11.28 and $6.20 per share, respectively. Had compensation costs for the Company's stock-based compensation plans been accounted for using the fair value method of accounting described by SFAS 123, the Company's net income and earnings per share would have been as follows (in thousands, except earnings per share):

| Fiscal Year Ended: | As Reported | Pro Forma Under SFAS 123 |
|---|---|---|
| September 28, 1997 | | |
| Net Income | $ 57,412 | $ 47,921 |
| Net earnings per common & common equivalent share: | | |
| Primary | $ 0.70 | $ 0.59 |
| Fully diluted | $ 0.70 | $ 0.59 |
| September 29, 1996 | | |
| Net Income | $ 42,128 | $ 38,525 |
| Net earnings per common & common equivalent share: | | |
| Primary | $ 0.55 | $ 0.50 |
| Fully diluted | $ 0.54 | $ 0.49 |

In applying SFAS 123, the impact of outstanding non-vested stock options granted prior to 1996 has been excluded from the pro forma calculations; accordingly, the 1997 and 1996 pro forma adjustments are not indicative of future period pro forma adjustments.

Defined Contribution Plans Starbucks maintains voluntary defined contribution plans covering eligible employees as defined in the plan documents. Participating employees may elect to defer and contribute a percentage of their compensation to the plan, not to exceed the dollar amount set by law. The Company matches 25% of each employee's contribution up to a maximum of the first 4% of each employee's compensation.

The Company's matching contributions to the plans were approximately $0.6 million, $0.3 million, and $0.3 million for fiscal 1997, 1996, and 1995, respectively.

**NOTE 11: INCOME TAXES**

A reconciliation of the statutory federal income tax rate with the Company's effective income tax rate is as follows:

| Fiscal year ended: | Sept 28, 1997 | Sept 29, 1996 | Oct 1, 1995 |
|---|---|---|---|
| Statutory rate | 35.0% | 35.0% | 35.0% |
| State income taxes, net of federal income tax benefit | 3.6 | 3.1 | 3.6 |
| Other | (.1) | 0.4 | 0.9 |
| Effective tax rate | 38.5% | 38.5% | 39.5% |

The provision for income taxes consists of the following (in thousands):

| Fiscal year ended: | Sept 28, 1997 | Sept 29, 1996 | Oct 1, 1995 |
|---|---|---|---|
| Currently payable: | | | |
| Federal | $25,884 | $19,568 | $14,672 |
| State | 4,725 | 2,398 | 2,285 |
| Deferred liability | 5,328 | 4,407 | 84 |
| | $35,937 | $26,373 | $17,041 |

Deferred income taxes (benefits) reflect the tax effect of temporary differences between the amounts of assets and liabilities for financial reporting purposes and amounts as measured for tax purposes. The tax effect of temporary differences and carry forwards that cause significant portions of deferred tax assets and liabilities are as follows (in thousands):

| | Sept 28, 1997 | Sept 29, 1996 |
|---|---|---|
| Depreciation | $ 17,136 | $ 10,699 |
| Accrued rent | (4,356) | (2,839) |
| Accrued compensation and related costs | (1,786) | (1,219) |
| Inventory | (1,474) | (1,531) |
| Unrealized holding gain on investments, net | 39 | 1,281 |
| Other, net | (939) | (1,857) |
| | $ 8,620 | $ 4,534 |

Taxes payable of $4.5 million and $2.7 million are included in "Other accrued expenses" as of September 28, 1997 and September 29, 1996, respectively.

**NOTE 12: COMMITMENTS AND CONTINGENCIES**

Under the amended terms of the Company's corporate office lease, the Company provides financing to the building owner to be used exclusively for facilities and leasehold development costs to accommodate the Company. Under this agreement, the Company advanced approximately $3.6 million, $4.3 million and $0.3 million during fiscal 1997, 1996, and 1995, respectively. As of September 28, 1997 and September 29, 1996, the amounts outstanding under the agreement totaled $8.2 million and $4.6 million, respectively. These amounts are included in "Deposits and other assets" on the balance sheet. The maximum amount available under the agreement is $17.0 million. Any funds advanced by the Company will be repaid with interest at 9.5% over a term not to exceed 20 years.

In the normal course of business, the Company has various legal claims and other contingent matters outstanding. Management believes that any ultimate liability arising from these actions would not have a material adverse effect on the Company's results of operations or financial condition as of and for the fiscal year ended September 28, 1997.

**NOTE 13: RELATED PARTY TRANSACTIONS**

An employee director of the Company serves as chairman of a wholesale customer of the Company. Sales to this customer were $31.0 million, $22.7 million, and $18.5 million for fiscal 1997, 1996, and 1995, respectively. Amounts receivable from this customer totaled $4.6 million and $2.7 million as of September 28, 1997 and September 29, 1996, respectively.

**NOTE 14: QUARTERLY FINANCIAL INFORMATION**

Summarized quarterly financial information for fiscal years 1997 and 1996 is as follows (in thousands, except earnings per share):

| | First | Second | Third | Fourth |
|---|---|---|---|---|
| 1997 quarter: | | | | |
| Net revenues | $239,142 | $214,915 | $242,190 | $270,699 |
| Gross margin | 123,583 | 115,766 | 139,565 | 155,842 |
| Net earnings | 14,390 | 9,643 | 14,616 | 18,763 |
| Net earnings per common & common equivalent share - fully diluted | $ 0.18 | 0.12 | $ 0.18 | $ 0.22 |
| 1996 quarter: | | | | |
| Net revenues | $169,537 | $153,609 | $176,950 | $196,385 |
| Gross margin | 83,019 | 76,671 | 93,786 | 107,205 |
| Net earnings | 9,566 | 10,391 | 9,446 | 12,725 |
| Net earnings per common & common equivalent share - fully diluted | $ 0.13 | 0.14 | $ 0.12 | $ 0.16 |

**STARBUCKS CORPORATION**

SEATTLE, WASHINGTON

We have audited the accompanying consolidated balance sheets of Starbucks Corporation and subsidiaries (the Company) as of September 28, 1997 and September 29, 1996, and the related consolidated statements of earnings, shareholders' equity, and cash flows for each of the three years in the period ended September 28, 1997. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Starbucks Corporation and subsidiaries as of September 28, 1997 and September 29, 1996, and the results of their operations and their cash flows for each of the three years in the period ended September 28, 1997, in conformity with generally accepted accounting principles.

Deloitte & Touche LLP
Seattle, Washington
November 21, 1997

**MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING**
**STARBUCKS CORPORATION**

The management of Starbucks Corporation is responsible for the preparation and integrity of the financial statements included in this Annual Report to Shareholders. The financial statements have been prepared in conformity with generally accepted accounting principles and include amounts based on management's best judgment where necessary. Financial information included elsewhere in this Annual Report is consistent with these financial statements.

Management maintains a system of internal controls and procedures designed to provide reasonable assurance that transactions are executed in accordance with proper authorization, that transactions are properly recorded in the Company's records, that assets are safeguarded, and that accountability for assets is maintained. The concept of reasonable assurance is based on the recognition that the cost of maintaining our system of internal accounting controls should not exceed benefits expected to be derived from the system. Internal controls and procedures are periodically reviewed and revised, when appropriate, due to changing circumstances and requirements.

Independent auditors are appointed by the Company's Board of Directors and ratified by the Company's share-holders to audit the financial statements in accordance with generally accepted auditing standards and to independently assess the fair presentation of the Company's financial position, results of operations, and cash flows. Their report appears in this Annual Report.

The Audit Committee of the Board of Directors, a majority of whom are outside directors, is responsible for monitoring the Company's accounting and reporting practices. The Audit Committee meets periodically with management and the independent auditors to ensure that each is properly discharging its responsibilities. The independent auditors have full and free access to the Committee without the presence of management to discuss the results of their audits, the adequacy of internal accounting controls, and the quality of financial reporting.

| | | |
|---|---|---|
| Howard Schultz<br>chairman and<br>chief executive officer | Orin Smith<br>president and<br>chief operating officer | Michael Casey<br>executive vice president and<br>chief financial officer |

**EXHIBIT 21**

**SUBSIDIARIES OF THE REGISTRANT**

**The Coffee Connection, Inc.**

**Starbucks New Venture Company**

**Starbucks Coffee International, Inc.**

**Starship I, Inc.**

**Starbucks Holding Company**

**Starbucks Manufacturing Corporation**

SBI Nevada, Inc. (a wholly-owned subsidiary of Starbucks Coffee International, Inc.)

**Circadia Corporation**

**Starbucks U.S. Brands Corporation**

**Starbucks Foreign Sales Corporation**

**EXHIBIT 23**

**INDEPENDENT AUDITORS' CONSENT**

We consent to the incorporation by reference in Registration Statements No. 33-52526, 33-52528, 33-92208 and 33-92184 of Starbucks Corporation on Forms S-8 of our report dated November 21, 1997, incorporated by reference in the Annual Report on Form 10-K of Starbucks Corporation for the year ended September 28, 1997.

*/s/ Deloitte & Touche LLP*
*DELOITTE & TOUCHE LLP*
*Seattle, Washington*
*December 19, 1997*

**ARTICLE 5**

MULTIPLIER: 1000

| | |
|---|---|
| PERIOD TYPE | YEAR |
| FISCAL YEAR END | SEP 28 1997 |
| PERIOD START | SEP 30 1996 |
| PERIOD END | SEP 28 1997 |
| CASH | 70,126 |
| SECURITIES | 83,504 |
| RECEIVABLES | 30,524 |
| ALLOWANCES | 273 |
| INVENTORY | 119,526 |
| CURRENT ASSETS | 316,607 |
| PP&E | 626,598 |
| DEPRECIATION | 143,339 |
| TOTAL ASSETS | 850,672 |
| CURRENT LIABILITIES | 139,029 |
| BONDS | 167,029 |
| PREFERRED MANDATORY | 0 |
| PREFERRED | 0 |
| COMMON | 386,877 |
| OTHER SE | 144,953 |
| TOTAL LIABILITY AND EQUITY | 850,672 |
| SALES | 966,946 |
| TOTAL REVENUES | 966,946 |
| CGS | 432,190 |
| TOTAL COSTS | 432,190 |
| OTHER EXPENSES | 446,534 |
| LOSS PROVISION | 0 |
| INTEREST EXPENSE | 7,266 |
| INCOME PRETAX | 93,349 |
| INCOME TAX | 35,937 |
| INCOME CONTINUING | 88,222 |
| DISCONTINUED | 0 |
| EXTRAORDINARY | 0 |
| CHANGES | 0 |
| NET INCOME | 57,412 |
| EPS PRIMARY | 0.70 |
| EPS DILUTED | 0.70 |

**End of Filing**