Murphy USA Inc.
Form 10-Q
August 04, 2016

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark one)
[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2016

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 001-35914

MURPHY USA INC.
(Exact name of registrant as specified in its charter)

Delaware	46-2279221
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

200 Peach Street	
El Dorado, Arkansas	71730-5836
(Address of principal executive offices)	(Zip Code)

(870) 875-7600
(Registrant's telephone number, including area code)
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
þ Yes __ No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). þ Yes __ No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer þ Accelerated filer __ Non-accelerated filer __ Smaller reporting company __

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
__Yes þ No
Number of shares of Common Stock, $0.01 par value, outstanding at June 30, 2016 was 39,163,458.

MURPHY USA INC.

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ITEM 1. FINANCIAL STATEMENTS
Murphy USA Inc.
Consolidated Balance Sheets

(Thousands of dollars)	June 30, 2016 (unaudited)	December 31, 2015
Assets		
Current assets		
Cash and cash equivalents	$254,210	$102,335
Accounts receivable—trade, less allowance for doubtful accounts of $1,988 in 2016 and $1,963 in 2015	148,211	136,253
Inventories, at lower of cost or market	152,494	155,906
Prepaid expenses and other current assets	17,066	41,173
Total current assets	571,981	435,667
Property, plant and equipment, at cost less accumulated depreciation and amortization of $732,114 in 2016 and $724,486 in 2015	1,430,816	1,369,318
Restricted cash	53,853	68,571
Other assets	27,196	12,685
Total assets	$2,083,846	$1,886,241
Liabilities and Stockholders' Equity		
Current liabilities		
Current maturities of long-term debt	$30,372	$222
Trade accounts payable and accrued liabilities	401,141	390,341
Income taxes payable	24,184	—
Deferred income taxes	—	1,729
Total current liabilities	455,697	392,292
Long-term debt, including capitalized lease obligations	648,266	490,160
Deferred income taxes	177,570	161,236
Asset retirement obligations	25,012	24,345
Deferred credits and other liabilities	19,389	25,918
Total liabilities	1,325,934	1,093,951
Stockholders' Equity		
Preferred Stock, par $0.01 (authorized 20,000,000 shares, none outstanding)	—	—
Common Stock, par $0.01 (authorized 200,000,000 shares, 46,767,164 and 46,767,164 shares issued at 2016 and 2015, respectively)	468	468
Treasury stock (7,603,706 and 5,088,434 shares held at June 30, 2016 and December 31, 2015, respectively)	(454,496)	(294,139)
Additional paid in capital (APIC)	551,977	558,182
Retained earnings	659,963	527,779
Total stockholders' equity	757,912	792,290
Total liabilities and stockholders' equity	$2,083,846	$1,886,241

See notes to consolidated financial statements.

Murphy USA Inc.
Consolidated Statements of Income
(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
(Thousands of dollars except per share amounts)	2016	2015	2016	2015
Revenues				
Petroleum product sales (a)	$2,371,735	$2,858,910	$4,260,019	$5,216,989
Merchandise sales	589,457	572,164	1,151,194	1,096,301
Other operating revenues	44,570	36,912	84,811	75,460
Total revenues	3,005,762	3,467,986	5,496,024	6,388,750
Costs and Operating Expenses				
Petroleum product cost of goods sold (a)	2,242,936	2,750,602	4,026,065	5,011,688
Merchandise cost of goods sold	496,801	488,540	972,603	939,093
Station and other operating expenses	125,145	122,377	241,919	236,912
Depreciation and amortization	23,685	21,215	47,171	42,318
Selling, general and administrative	32,320	32,886	63,823	63,979
Accretion of asset retirement obligations	412	379	825	757
Total costs and operating expenses	2,921,299	3,415,999	5,352,406	6,294,747
Income from operations	84,463	51,987	143,618	94,003
Other income (expense)				
Interest income	250	15	330	1,888
Interest expense	(10,210)	(8,329)	(19,598)	(16,658)
Gain (loss) on sale of assets	(490)	(23)	88,975	(19)
Other nonoperating income (expense)	85	(4,854)	118	510
Total other income (expense)	(10,365)	(13,191)	69,825	(14,279)
Income before income taxes	74,098	38,796	213,443	79,724
Income tax expense	27,788	13,976	81,259	31,387
Income from continuing operations	46,310	24,820	132,184	48,337
Income (loss) from discontinued operations, net of taxes	—	1,371	—	786
Net Income	$46,310	$26,191	$132,184	$49,123
Earnings per share - basic:				
Income from continuing operations	$1.18	$0.56	$3.29	$1.07
Income (loss) from discontinued operations	—	0.03	—	0.02
Net Income - basic	$1.18	$0.59	$3.29	$1.09
Earnings per share - diluted:				
Income from continuing operations	$1.17	$0.56	$3.26	$1.07
Income (loss) from discontinued operations	—	0.03	—	0.02
Net Income - diluted	$1.17	$0.59	$3.26	$1.09
Weighted-average shares outstanding (in thousands):				
Basic	39,360	44,078	40,134	44,851
Diluted	39,720	44,409	40,505	45,218
Supplemental information:				
(a) Includes excise taxes of:	$487,923	$483,470	$960,533	$946,444

See notes to consolidated financial statements.

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Murphy USA Inc.
Consolidated Statements of Cash Flows
(unaudited)

(Thousands of dollars)	Six Months Ended June 30, 2016	2015
Operating Activities		
Net income	$ 132,184	$ 49,123
Adjustments to reconcile net income to net cash provided by operating activities		
(Income) loss from discontinued operations, net of taxes	—	(786)
Depreciation and amortization	47,171	42,318
Deferred and noncurrent income tax charges (credits)	14,605	(9,468)
Accretion of asset retirement obligations	825	757
Pretax (gains) losses from sale of assets	(88,975)	19
Net (increase) decrease in noncash operating working capital	57,427	(24,910)
Other operating activities - net	5,365	8,010
Net cash provided by continuing operations	168,602	65,063
Net cash provided by discontinued operations	—	12,753
Net cash provided by operating activities	168,602	77,816
Investing Activities		
Property additions	(116,569)	(87,895)
Proceeds from sale of assets	86,298	91
Changes in restricted cash	13,429	—
Other investing activities - net	(15,138)	—
Investing activities of discontinued		

operations		
Other	—	(3,762)
Net cash required by investing activities	(31,980)	(91,566)
Financing Activities		
Purchase of treasury stock	(167,105)	(189,834)
Borrowings of debt	200,000	—
Repayments of debt	(10,165)	(46)
Debt issuance costs	(3,240)	—
Amounts related to share-based compensation	(4,237)	(3,030)
Net cash provided by (required by) financing activities	15,253	(192,910)
Net increase (decrease) in cash and cash equivalents	151,875	(206,660)
Cash and cash equivalents at January 1	102,335	328,105
Cash and cash equivalents at June 30	254,210	121,445
Less: Cash and cash equivalents held for sale	—	976
Cash and cash equivalents of continuing operations at June 30	$ 254,210	$ 120,469

See notes to consolidated financial statements.

Murphy USA Inc.
Consolidated Statements of Changes in Equity
(unaudited)

(Thousands of dollars, except share amounts)	Common Stock Shares	Par	Treasury Stock	APIC	Retained Earnings	Total
Balance as of December 31, 2014	46,767,164	$468	$(51,073)	$557,871	$351,439	$858,705
Net income	—	—	—	—	49,123	49,123
Purchase of treasury stock	—	—	(189,834)	—	—	(189,834)
Issuance of common stock	—	—	—	—	—	—
Issuance of treasury stock	—	—	5,517	(5,517)	—	—
Amounts related to share-based compensation	—	—	—	(3,030)	—	(3,030)
Share-based compensation expense	—	—	—	4,353	—	4,353
Balance as of June 30, 2015	46,767,164	$468	$(235,390)	$553,677	$400,562	$719,317

(Thousands of dollars, except share amounts)	Common Stock Shares	Par	Treasury Stock	APIC	Retained Earnings	Total
Balance as of December 31, 2015	46,767,164	$468	$(294,139)	$558,182	$527,779	$792,290
Net income	—	—	—	—	132,184	132,184
Purchase of treasury stock	—	—	(167,105)	—	—	(167,105)
Issuance of common stock	—	—	—	—	—	—
Issuance of treasury stock	—	—	6,748	(6,748)	—	—
Amounts related to share-based compensation	—	—	—	(4,237)	—	(4,237)
Share-based compensation expense	—	—	—	4,780	—	4,780
Balance as of June 30, 2016	46,767,164	$468	$(454,496)	$551,977	$659,963	$757,912

See notes to consolidated financial statements.

Murphy USA Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 — Description of Business and Basis of Presentation

Description of business — Murphy USA Inc. (“Murphy USA” or the “Company”) markets refined products through a network of retail gasoline stations and to unbranded wholesale customers. Murphy USA’s owned retail stations are almost all located in close proximity to Walmart stores in 24 states and use the brand name Murphy USA®. Murphy USA also markets gasoline and other products at standalone stations under the Murphy Express brand. At June 30, 2016, Murphy USA had a total of 1,344 Company stations.

Basis of Presentation — Murphy USA was incorporated in March 2013 and, in connection with its incorporation, Murphy USA issued 100 shares of common stock, par value $0.01 per share, to Murphy Oil Corporation (“Murphy Oil” or “Parent”) for $1.00. On August 30, 2013, Murphy USA was separated from Murphy Oil through the distribution of 100% of the common stock of Murphy USA to holders of Murphy Oil stock.

In preparing the financial statements of Murphy USA in conformity with accounting principles generally accepted in the United States, management has made a number of estimates and assumptions related to the reporting of assets, liabilities, revenues, expenses and the disclosure of contingent assets and liabilities. Actual results may differ from these estimates.

Interim Financial Information — The interim period financial information presented in these consolidated financial statements is unaudited and includes all known accruals and adjustments, in the opinion of management, necessary for a fair presentation of the consolidated financial position of Murphy USA and its results of operations and cash flows for the periods presented. All such adjustments are of a normal and recurring nature.

These interim consolidated financial statements should be read together with our audited financial statements for the years ended December 31, 2015, 2014 and 2013, included in our Annual Report on Form 10-K (File No. 001-35914), as filed with the Securities and Exchange Commission under the Securities Exchange Act of 1934 on February 26, 2016.

Recently Issued Accounting Standards— In November 2015, the FASB issued ASU No. 2015-17, "Balance Sheet Classification of Deferred Taxes," which amended existing accounting guidance related to the presentation of deferred tax liabilities and assets. The amended guidance requires that all deferred tax liabilities and assets be classified as noncurrent on the balance sheet. This guidance is effective for reporting periods beginning after December 15, 2016; however, early adoption is permitted at the beginning of a fiscal year. The Company adopted ASU No. 2015-17 during the quarter ended March 31, 2016 and has applied this guidance prospectively to its deferred tax liabilities and assets. For the period ended December 31, 2015, current deferred tax liabilities of $1.7 million remain classified as current in the accompanying balance sheet.

In February 2016, the FASB issued ASU No. 2016-02, "Leases (Topic 842)" (“ASU 2016-02”). ASU 2016-02 amends the existing accounting standards for lease accounting, including requiring lessees to recognize most leases on their balance sheets. Lessor accounting will remain similar to lessor accounting under previous GAAP, while aligning with the FASB’s new revenue recognition guidance. ASU 2016-02 is effective for the Company beginning January 1, 2019. Early adoption of ASU 2016-02 is permitted. The standard requires a modified retrospective transition approach for all leases existing at, or entered into after, the date of initial application, with an option to use certain transition relief. We are evaluating the impact ASU 2016-02 will have on our consolidated financial statements.

On March 30, 2016, the FASB issued ASU No. 2016-09, "Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting", which amends the current stock compensation guidance. The amendments simplify the accounting for the taxes related to stock based compensation, including adjustments to how excess tax benefits and a company's payments for tax withholdings should be classified. The standard is effective for fiscal periods beginning after December 15, 2016, with early adoption permitted. We are currently evaluating the impact of the adoption of this standard on our consolidated financial statements and currently expect to adopt the standard effective January 1, 2017.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 2 – Discontinued Operations

In September 2015, the Company determined that it had met held for sale criteria for its Hereford, Texas ethanol production facility. On September 25, 2015, the Company signed a letter of intent to sell this subsidiary for a gain and the transaction closed on November 12, 2015.

The financial results of our Hereford plant for the three and six months ended June 30, 2015 are presented as income from discontinued operations, net of income taxes on our condensed consolidated statement of income. The results of the Hereford ethanol plant were previously included along with "Corporate" as a reconciling item within our segment footnote prior to third quarter 2015. The following table presents financial results of the Hereford business:

(Thousands of dollars)	Three Months Ended June 30, 2015	Six Months Ended June 30, 2015
Revenues		
Ethanol sales	$49,235	$90,986
Total revenues	49,235	90,986
Costs and operating expenses		
Ethanol cost of goods sold	38,440	73,020
Station and other operating expenses	8,095	15,735
Depreciation and amortization	102	177
Selling, general and administrative expenses	364	726
Total costs and operating expenses	47,001	89,658
Income (loss) from operations	2,234	1,328
Other income (expense)		
Gain (loss) on sale of assets	—	—
Other nonoperating income (expense)	—	—
Total other income (expense)	—	—
Income (loss) before income taxes	2,234	1,328
Income tax expense (benefit)	863	542
Net income (loss)	$1,371	$786

The following table presents cash flow of the Hereford ethanol plant:

(Thousands of dollars)	Three Months Ended June 30, 2015	Six Months Ended June 30, 2015
Net cash provided by discontinued operating activities	8,462	12,753
Net cash used in discontinued investing activities	(2,807)	(3,762)

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 3 — Inventories

Inventories consisted of the following:

(Thousands of dollars)	June 30, 2016	December 31, 2015
Finished products - FIFO basis	$197,407	$ 159,774
Less LIFO reserve - finished products	(140,417)	(102,849)
Finished products - LIFO basis	56,990	56,925
Store merchandise for resale	92,222	94,925
Materials and supplies	3,282	4,056
Total inventories	$152,494	$ 155,906

At June 30, 2016 and December 31, 2015, the replacement cost (market value) of last-in, first-out (LIFO) inventories exceeded the LIFO carrying value by $140,417,000 and $102,849,000, respectively.

Note 4 — Long-Term Debt

Long-term debt consisted of the following:

(Thousands of dollars)	June 30, 2016	December 31, 2015
6% senior notes due 2023 (net of unamortized discount of $6,259 at June 2016 and $6,692 at December 2015)	$493,741	$ 493,308
Term loan due 2020 (effective rate of 3.41% at June 30, 2016)	190,000	—
Less unamortized debt issuance costs	(6,046)	(3,526)
Total notes payable, net	677,695	489,782
Capitalized lease obligations, vehicles, due through 2019	943	600
Less current maturities	(30,372)	(222)
Total long-term debt	$648,266	$ 490,160

Senior Notes

On August 14, 2013, Murphy Oil USA, Inc., our primary operating subsidiary, issued 6.00% Senior Notes due 2023 (the “Senior Notes”) in an aggregate principal amount of $500 million. The Senior Notes are fully and unconditionally guaranteed by Murphy USA, and are guaranteed by certain 100% owned subsidiaries that guarantee our credit facilities. The indenture governing the Senior Notes contains restrictive covenants that limit, among other things, the ability of Murphy USA, Murphy Oil USA, Inc. and the restricted subsidiaries to incur additional indebtedness or liens, dispose of assets, make certain restricted payments or investments, enter into transactions with affiliates or merge with or into other entities.

The Senior Notes and the guarantees rank equally with all of our and the guarantors’ existing and future senior unsecured indebtedness and effectively junior to our and the guarantors’ existing and future secured indebtedness (including indebtedness with respect to the credit facilities) to the extent of the value of the assets securing such indebtedness. The Senior Notes are structurally subordinated to all of the existing and future third-party liabilities, including trade payables, of our existing and future subsidiaries that do not guarantee the notes.

We used the net proceeds of the Senior Notes, together with borrowings under the credit facilities, to finance a cash dividend of $650 million from Murphy Oil USA, Inc. to Murphy Oil paid in connection with the separation.

On June 17, 2014, we closed an exchange offer for our Senior Notes to make them eligible for public resale, as required by a registration rights agreement entered into in connection with the issuance of the Senior Notes. All of the Senior Notes were tendered for exchange.

Credit Facilities

In March 2016, we amended and extended our existing credit agreement. The credit agreement provides for a committed $450 million asset-based loan (ABL) facility (with availability subject to the borrowing base described below) and a $200 million term loan facility. It also provides for a $150 million uncommitted incremental facility. On March 10, 2016, Murphy Oil USA, Inc. borrowed $200 million under the term loan facility that has a four-year term.

The borrowing base is, at any time of determination, the amount (net of reserves) equal to the sum of:

- 100% of eligible cash at such time, plus
- 90% of eligible credit card receivables at such time, plus
- 90% of eligible investment grade accounts, plus
- 85% of eligible other accounts, plus
- 80% of eligible product supply/wholesale refined products inventory at such time, plus
- 75% of eligible retail refined products inventory at such time, plus

the lesser of (i) 70% of the average cost of eligible retail merchandise inventory at such time and (ii) 85% of the net orderly liquidation value of eligible retail merchandise inventory at such time.

The ABL facility includes a $200 million sublimit for the issuance of letters of credit. Letters of credit issued under the ABL facility reduce availability under the ABL facility.

Interest payable on the credit facilities is based on either:

- the London interbank offered rate, adjusted for statutory reserve requirements (the “Adjusted LIBO Rate”); or
- the Alternate Base Rate, which is defined as the highest of (a) the prime rate, (b) the federal funds effective rate from time to time plus 0.50% per annum and (c) the one-month Adjusted LIBO Rate plus 1.00% per annum,

plus, (A) in the case of Adjusted LIBO Rate borrowings, (i) with respect to the ABL facility, spreads ranging from 1.50% to 2.00% per annum depending on a total debt to EBITDA ratio under the ABL facility or (ii) with respect to the term loan facility, spreads ranging from 2.50% to 2.75% per annum depending on a total debt to EBITDA ratio and (B) in the case of Alternate Base Rate borrowings, (i) with respect to the ABL facility, spreads ranging from 0.50% to 1.00% per annum depending on total debt to EBITDA ratio or (ii) with respect to the term loan facility, spreads ranging from 1.50% to 1.75% per annum depending on a total debt to EBITDA ratio.

The interest rate period with respect to the Adjusted LIBO Rate interest rate option can be set at one, two, three, or six months as selected by us in accordance with the terms of the credit agreement.

We are obligated to make quarterly amortization payments on the outstanding principal amount of the term loan facility beginning on July 1, 2016 equal to 5% of the aggregate principal amount of term loans made on March 10, 2016, with the remaining balance payable on the scheduled maturity date of the term loan facility. We made the first payment on the term loan for $10 million on June 30, 2016. Borrowings under the credit facilities are prepayable at our option without premium or penalty. We are also required to prepay the term loan facility with the net cash proceeds of certain asset sales or casualty events, subject to certain exceptions. The credit agreement also includes

certain customary mandatory prepayment provisions with respect to the ABL facility.

The credit agreement contains certain covenants that limit, among other things, the ability of us and our subsidiaries to incur additional indebtedness or liens, to make certain investments, to enter into sale-leaseback transactions, to make certain restricted payments, to enter into consolidations, mergers or sales of material assets and other fundamental changes, to transact with affiliates, to enter into agreements restricting the ability of subsidiaries to incur liens or pay dividends, or to make certain accounting changes. In addition, the credit agreement requires us to maintain a minimum fixed charge coverage ratio of a minimum of 1.0 to 1.0 when availability for at least three consecutive business days is less than the greater of (a) 17.5% of the lesser of the aggregate ABL facility commitments and the borrowing base and (b) $70,000,000 (including as of the most recent fiscal quarter end on the first date when availability is less than such amount), as well as a maximum secured total debt to EBITDA ratio of

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

4.5 to 1.0 at any time when the term loans are outstanding. As of June 30, 2016, our fixed charge coverage ratio was 0.70; however, we had no debt outstanding under the ABL facility at that date so the fixed charge coverage ratio currently has no impact on our operations or liquidity.

After giving effect to the applicable restrictions on certain payments, which could include dividends, under the credit agreement (which restrictions are only applicable when availability under the credit agreement does not exceed the greater of 25% of the lesser of the revolving commitments and the borrowing base and $100 million (and if availability under the credit agreement does not exceed the greater of 40% of the lesser of the revolving commitments and the borrowing base and $100 million, then our fixed charge coverage ratio must be at least 1.0 to 1.0)) and the indenture, and subject to compliance with applicable law. As of December 31, 2015, the Company had a shortfall of approximately $245.7 million of its net income and retained earnings subject to such restrictions before the fixed charge coverage ratio would exceed 1.0 to 1.0.

All obligations under the credit agreement are guaranteed by Murphy USA and the subsidiary guarantors party thereto, and all obligations under the credit agreement, including the guarantees of those obligations, are secured by certain assets of Murphy USA, Murphy Oil USA, Inc. and the guarantors party thereto.

Note 5 — Asset Retirement Obligations (ARO)
The majority of the ARO recognized by the Company at June 30, 2016 and December 31, 2015 related to the estimated costs to dismantle and abandon certain of its retail gasoline stations. The Company has not recorded an ARO for certain of its marketing assets because sufficient information is presently not available to estimate a range of potential settlement dates for the obligation. These assets are consistently being upgraded and are expected to be operational into the foreseeable future. In these cases, the obligation will be initially recognized in the period in which sufficient information exists to estimate the obligation.
A reconciliation of the beginning and ending aggregate carrying amount of the ARO is shown in the following table.

(Thousands of dollars)	June 30, 2016	December 31, 2015
Balance at beginning of period	$24,345	$ 22,245
Accretion expense	825	1,521
Liabilities incurred	6	579
Settlement of liabilities	$(164)	$ —
Balance at end of period	$25,012	$ 24,345

The estimation of future ARO is based on a number of assumptions requiring professional judgment. The Company cannot predict the type of revisions to these assumptions that may be required in future periods due to the lack of availability of additional information.

Note 6— Income Taxes

The effective tax rate is calculated as the amount of income tax expense divided by income before income tax expense. For the three and six month periods ended June 30, 2016 and 2015, the Company’s effective tax rates were as follows:

	2016	2015
Three months ended June 30,	37.5%	36.0%

Six months ended June 30,	38.1%	39.4%

The effective tax rate for the three and six months ended June 30, 2016 was higher than the U.S. Federal tax rate of 35% primarily due to U.S. state tax expense while the effective rates for the prior year periods were higher than the statutory rate primarily due to certain discrete items that impacted income taxes in the period in addition to U.S. state tax expense.

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The Company was included in Murphy Oil's tax returns for the periods prior to the separation in multiple jurisdictions that remain subject to audit by taxing authorities. These audits often take years to complete and settle. As of June 30, 2016, the earliest year remaining open for Federal audit and/or settlement is 2012 and for the states it ranges from 2008-2011. Although the Company believes that recorded liabilities for unsettled issues are adequate, additional gains or losses could occur in future periods from resolution of outstanding unsettled matters.

Note 7 — Incentive Plans

2013 Long-Term Incentive Plan

Effective August 30, 2013, certain of our employees participate in the Murphy USA 2013 Long-Term Incentive Plan which was subsequently amended and restated effective as of February 12, 2014 (the "MUSA 2013 Plan"). The MUSA 2013 Plan authorizes the Executive Compensation Committee of our Board of Directors ("the Committee") to grant non-qualified or incentive stock options, stock appreciation rights, stock awards (including restricted stock and restricted stock unit awards), cash awards, and performance awards to our employees. No more than 5.5 million shares of MUSA common stock may be delivered under the MUSA 2013 Plan and no more than 1 million shares of common stock may be awarded to any one employee, subject to adjustment for changes in capitalization. The maximum cash amount payable pursuant to any "performance-based" award to any participant in any calendar year is $5 million.

On February 10, 2016, the Committee granted nonqualified stock options for 96,500 shares at an exercise price of $59.11 per share under the terms of the MUSA 2013 Plan. The Black-Scholes valuation for these awards is $16.08 per option. The Committee also awarded time-based restricted stock units and performance-based restricted stock units (performance units) to certain employees on the same date. There were 26,650 time-based restricted units granted at a grant date fair value of $59.11 along with 53,300 performance units. Half of the performance units vest based on a 3-year return on average capital employed (ROACE) calculation and the other half vest based on a 3-year total shareholder return (TSR) calculation that compares MUSA to a group of 16 peer companies. The portion of the awards that vest based on TSR qualify as a market condition and must be valued using a Monte Carlo valuation model. For the TSR portion of the awards, the fair value was determined to be $82.94 per unit. For the ROACE portion of the awards, the valuation will be based on the grant date fair value of $59.11 per unit and the number of awards will be periodically assessed to determine the probability of vesting.

On February 10, 2016, the Committee also granted 45,475 time-based restricted stock units granted to certain employees with a grant date fair value of $59.11 per unit.

2013 Stock Plan for Non-employee Directors

Effective August 8, 2013, Murphy USA adopted the 2013 Murphy USA Stock Plan for Non-employee Directors (the "Directors Plan"). The directors for Murphy USA are compensated with a mixture of cash payments and equity-based awards. Awards under the Directors Plan may be in the form of restricted stock, restricted stock units, stock options, or a combination thereof. An aggregate of 500,000 shares of common stock shall be available for issuance of grants under the Directors Plan.

During the first quarter of 2016, the Company issued 19,900 restricted stock units to its non-employee directors at a weighted average grant date fair value of $59.14 per share. These shares vest in three years from the grant date.

For the six months ended June 30, 2016 and 2015, share based compensation was $4.8 million and $4.4 million, respectively. The income tax benefit realized for the tax deductions from options exercised for the six months ended June 30, 2016 was $1.4 million.

Note 8— Financial Instruments and Risk Management

DERIVATIVE INSTRUMENTS — The Company makes limited use of derivative instruments to manage certain risks related to commodity prices. The use of derivative instruments for risk management is covered by operating policies and is closely monitored by the Company's senior management. The Company does not hold any derivatives for speculative purposes and it does not use derivatives with leveraged or complex features. Derivative instruments are traded primarily with creditworthy major financial institutions or over national exchanges such as the New York Mercantile Exchange ("NYMEX"). As of June 30, 2016, all current derivative activity is immaterial.

Murphy USA Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

At June 30, 2016 and December 31, 2015, cash deposits of $2.0 million and $1.6 million related to commodity derivative contracts were reported in Prepaid expenses and other current assets in the Consolidated Balance Sheets, respectively. These cash deposits have not been used to increase the reported net assets or reduce the reported net liabilities on the derivative contracts at June 30, 2016 or December 31, 2015, respectively.

Note 9 – Earnings Per Share

Basic earnings per common share is computed by dividing net income available to common stockholders by the weighted average of common shares outstanding during the period. Diluted earnings per common share adjusts basic earnings per common share for the effects of stock options and restricted stock in the periods where such items are dilutive.

On January 25, 2016, the Company announced that it would proceed with an independent growth plan apart from Walmart rather than continue to acquire land from Walmart. In conjunction with this announcement, the Board of Directors approved a strategic allocation of capital for the Company to pursue new additional growth opportunities and to undertake a share repurchase program of the Company's common stock. The Board authorized up to $500 million in total for the two capital programs through December 31, 2017. For the first six months ended June 30, 2016, the Company has acquired 2,631,608 shares of common stock for an average price of $63.50 per share including brokerage fees.

The following table provides a reconciliation of basic and diluted earnings per share computations for the three and six months ended June 30, 2016 and 2015 (in thousands, except per share amounts):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Earnings per common share:				
Net income (loss) per share - basic				
Income from continuing operations	$46,310	$24,820	$132,184	$48,337
Income (loss) from discontinued operations	—	1,371	—	786
Net income attributable to common stockholders	$46,310	$26,191	$132,184	$49,123
Weighted average common shares outstanding (in thousands)	39,360	44,078	40,134	44,851
Earnings per share:				
Continuing operations	$1.18	$0.56	$3.29	$1.07
Discontinued operations	—	0.03	—	0.02
Total earnings per share	$1.18	$0.59	$3.29	$1.09

Murphy USA Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Earnings per common share - assuming dilution:				
Net income (loss) per share - diluted				
Income from continuing operations	$46,310	$24,820	$132,184	$48,337
Income (loss) from discontinued operations	—	1,371	—	786
Net income attributable to common stockholders	$46,310	$26,191	$132,184	$49,123
Weighted average common shares outstanding (in thousands)	39,360	44,078	40,134	44,851
Common equivalent shares:				
Dilutive options	360	331	371	367
Weighted average common shares outstanding - assuming dilution (in thousands)	39,720	44,409	40,505	45,218
Earnings per share:				
Continuing operations	$1.17	$0.56	$3.26	$1.07
Discontinued operations	—	0.03	—	0.02
Earnings per share - assuming dilution	$1.17	$0.59	$3.26	$1.09

Note 10 — Other Financial Information

OTHER OPERATING REVENUES – Other operating revenues in the Consolidated Statements of Income include the following items:

	Three Months Ended June 30,		Six Months Ended June 30,	
(Thousands of dollars)	2016	2015	81.4	70.3 —
Trading securities	76.9	76.9	—	—
Total short-term investments	228.6	158.3	70.3	—
Prepaid expenses and other current assets:				
Derivative assets	13.4	0.1	13.3	—
Long-term investments:				
Available-for-sale securities				
Agency obligations	21.8	—	21.8	—
Corporate debt securities	207.4	—	207.4	—
Auction rate securities	5.9	—	—	5.9
Foreign government obligations	17.1	—	17.1	—
U.S. government treasury securities	127.4	127.4	—	—
State and local government obligations	7.0	—	7.0	—
Mortgage and other asset-backed securities	155.7	—	155.7	—
Total long-term investments	542.3	127.4	409.0	5.9
Other long-term assets:				
Derivative assets	24.4	—	24.4	—
Total assets	$3,271.0	$2,748.1	$517.0	$5.9
Liabilities:				
Accrued liabilities:				
Derivative liabilities	$16.4	$2.5	$13.9	$—
Other long-term liabilities:				
Derivative liabilities	22.1	—	22.1	—
Total	$38.5	$2.5	$36.0	$—

There were no material transfers between levels, and there was no significant activity within Level 3 instruments during the periods presented. The fair values of any financial instruments presented above exclude the impact of netting assets and liabilities when a legally enforceable master netting agreement exists.

Gross unrealized holding gains and losses on investments were not material as of December 31, 2017 and October 1, 2017.

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Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

Assets and liabilities recognized or disclosed at fair value on the condensed consolidated financial statements on a nonrecurring basis include items such as property, plant and equipment, goodwill and other intangible assets, equity and cost method investments and other assets. These assets are measured at fair value if determined to be impaired. During the quarters ended December 31, 2017 and January 1, 2017, there were no material fair value adjustments.

The estimated fair value of our long-term debt based on the quoted market price (Level 2) is included at Note 7, Debt.

Note 5: Inventories (in millions)

	Dec 31, 2017	Oct 1, 2017	Jan 1, 2017
Coffee:			
Unroasted	$559.9	$541.0	$550.5
Roasted	283.9	301.1	255.7
Other merchandise held for sale	260.6	301.1	256.2
Packaging and other supplies	208.8	220.8	156.3
Total	$1,313.2	$1,364.0	$1,218.7

Other merchandise held for sale includes, among other items, serveware and tea. Inventory levels vary due to seasonality, commodity market supply and price fluctuations.

As of December 31, 2017, we had committed to purchasing green coffee totaling $762 million under fixed-price contracts and an estimated $369 million under price-to-be-fixed contracts. As of December 31, 2017, none of our price-to-be fixed contracts were effectively fixed through the use of futures contracts. Price-to-be-fixed contracts are purchase commitments whereby the quality, quantity, delivery period, and other negotiated terms are agreed upon, but the date, and therefore the price, at which the base “C” coffee commodity price component will be fixed has not yet been established. For most contracts, either Starbucks or the seller has the option to “fix” the base “C” coffee commodity price prior to the delivery date. For other contracts, Starbucks and the seller may agree upon pricing parameters determined by the base “C” coffee commodity price. Until prices are fixed, we estimate the total cost of these purchase commitments. We believe, based on relationships established with our suppliers in the past, the risk of non-delivery on these purchase commitments is remote.

Note 6: Supplemental Balance Sheet Information (in millions)

Prepaid Expenses and Other Current Assets

	Dec 31, 2017	Oct 1, 2017
Receivable from Taiwan divestiture	$177.1	$—
Income tax receivable	438.4	68.0
Other prepaid expenses and current assets	335.0	290.1
Total prepaid expenses and current assets	$950.5	$358.1

Property, Plant and Equipment, net

	Dec 31, 2017	Oct 1, 2017
Land	$46.9	$46.9
Buildings	487.2	481.7
Leasehold improvements	6,844.0	6,401.0
Store equipment	2,234.3	2,110.7
Roasting equipment	622.0	619.8
Furniture, fixtures and other	1,599.2	1,514.1
Work in progress	395.8	409.8
Property, plant and equipment, gross	12,229.4	11,584.0

Accumulated depreciation	(6,850.7)	(6,664.5)
Property, plant and equipment, net	$5,378.7	$4,919.5

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Accrued Liabilities

	Dec 31, 2017	Oct 1, 2017
Accrued compensation and related costs	$535.2	$524.5
Accrued occupancy costs	178.4	151.3
Accrued taxes	421.5	226.6
Accrued dividends payable	422.3	429.5
Accrued capital and other operating expenditures	772.7	602.6
Payable for East China Acquisition	1,431.0	—
Total accrued liabilities	$3,761.1	$1,934.5

Note 7: Debt

Short-term Debt

Under our commercial paper program, we may issue unsecured commercial paper notes up to a maximum aggregate amount outstanding at any time of $3 billion, with individual maturities that may vary but not exceed 397 days from the date of issue. Amounts outstanding under the commercial paper program are required to be backstopped by available commitments under our credit facility. The proceeds from borrowings under our commercial paper program may be used for working capital needs, capital expenditures and other corporate purposes, including, but not limited to, business expansion, payment of cash dividends on our common stock and share repurchases. As of December 31, 2017, we had no borrowings outstanding under the program.

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Long-term Debt

Components of long-term debt including the associated interest rates and related estimated fair values by calendar maturity (in millions, except interest rates):

	Dec 31, 2017		Oct 1, 2017			
Issuance	Amount	Estimated Fair Value	Amount	Estimated Fair Value	Stated Interest Rate	Effective Interest Rate [1]
2018 notes	$350.0	$ 350	$350.0	$ 352	2.000 %	2.012 %
2020 notes[2]	500.0	500	—	—	2.200 %	2.228 %
2021 notes	500.0	497	500.0	501	2.100 %	2.293 %
2021 notes	250.0	248	250.0	250	2.100 %	1.600 %
2022 notes	500.0	504	500.0	508	2.700 %	2.819 %
2023 notes	750.0	796	750.0	806	3.850 %	2.859 %
2024 notes [3]	755.3	762	755.3	760	0.372 %	0.462 %
2026 notes	500.0	480	500.0	481	2.450 %	2.511 %
2045 notes	350.0	387	350.0	381	4.300 %	4.348 %
2047 notes[2]	500.0	509	—	—	3.750 %	3.765 %
Total	4,955.3	5,033	3,955.3	4,039		
Aggregate debt issuance costs and unamortized premium, net	(26.1)		(17.5)			
Hedge accounting fair value adjustment [4]	(12.8)		(5.2)			
Total	$4,916.4		$3,932.6			

(1) Includes the effects of the amortization of any premium or discount and any gain or loss upon settlement of related treasury locks or forward-starting interest rate swaps utilized to hedge the interest rate risk prior to the debt issuance.

(2) Issued in November 2017.

(3) Japanese yen-denominated long-term debt.

(4) Amount represents the change in fair value due to changes in benchmark interest rates related to our 2023 notes. Refer to Note 3, Derivative Financial Instruments, for additional information on our interest rate swap designated as a fair value hedge.

The indentures under which the above notes were issued require us to maintain compliance with certain covenants, including limits on future liens and sale and leaseback transactions on certain material properties. As of December 31, 2017, we were in compliance with all applicable covenants.

The following table summarizes our long-term debt maturities as of December 31, 2017 by fiscal year (in millions):

Fiscal Year	Total
2019	$350.0
2020	—
2021	1,250.0
2022	500.0
2023	—
Thereafter	2,855.3
Total	$4,955.3

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Note 8: Equity

Changes in total equity (in millions):

	Quarter Ended Dec 31, 2017			Jan 1, 2017		
	Attributable to Starbucks	Noncontrolling interests	Total Equity	Attributable to Starbucks	Noncontrolling interest	Total Equity
Beginning balance of total equity	$5,450.1	$ 6.9	$5,457.0	$5,884.0	$ 6.7	$5,890.7
Net earnings including noncontrolling interests	2,250.2	(0.1)	2,250.1	751.8	(0.3)	751.5
Translation adjustment and other, net of reclassifications and tax	28.1	—	28.1	(171.8)	—	(171.8)
Unrealized gains/(losses), net of reclassifications and tax	2.2	—	2.2	37.9	—	37.9
Other comprehensive income/(loss)	30.3	—	30.3	(133.9)	—	(133.9)
Stock-based compensation expense	62.2	—	62.2	55.7	—	55.7
Exercise of stock options/vesting of RSUs	(9.1)	—	(9.1)	8.8	—	8.8
Sale of common stock	7.4	—	7.4	7.0	—	7.0
Repurchase of common stock	(1,618.2)	—	(1,618.2)	(413.7)	—	(413.7)
Cash dividends declared	(420.8)	—	(420.8)	(363.1)	—	(363.1)
Ending balance of total equity	$5,752.1	$ 6.8	$5,758.9	$5,796.6	$ 6.5	$5,803.1

Changes in AOCI by component, net of tax (in millions):

Quarter Ended

	Available-for-Sale Securities	Cash Flow Hedges	Net Investment Hedges	Translation Adjustment and Other	Total
December 31, 2017					
Net gains/(losses) in AOCI, beginning of period	$ (2.5)	$ (4.1)	$ 14.0	$ (163.0)	$ (155.6)
Net gains/(losses) recognized in OCI before reclassifications	(1.8)	(2.9)	(0.2)	20.9	16.0
Net (gains)/losses reclassified from AOCI to earnings	1.3	5.9	(0.1)	7.2	14.3
Other comprehensive income/(loss) attributable to Starbucks	(0.5)	3.0	(0.3)	28.1	30.3
Net gains/(losses) in AOCI, end of period	$ (3.0)	$ (1.1)	$ 13.7	$ (134.9)	$ (125.3)
January 1, 2017					
Net gains/(losses) in AOCI, beginning of period	$ 1.1	$ 10.9	$ 1.3	$ (121.7)	$ (108.4)
Net gains/(losses) recognized in OCI before reclassifications	(9.3)	87.0	25.9	(171.8)	(68.2)
Net (gains)/losses reclassified from AOCI to earnings	0.6	(66.3)	—	—	(65.7)
Other comprehensive income/(loss) attributable to Starbucks	(8.7)	20.7	25.9	(171.8)	(133.9)
Net gains/(losses) in AOCI, end of period	$ (7.6)	$ 31.6	$ 27.2	$ (293.5)	$ (242.3)

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Impact of reclassifications from AOCI on the consolidated statements of earnings (in millions):

Quarter Ended			
AOCI Components	Amounts Reclassified from AOCI		Affected Line Item in the Statements of Earnings
	Dec 31, 2017	Jan 1, 2017	
Gains/(losses) on available-for-sale securities	$ (1.7)	$ (0.8)	Interest income and other, net
Gains/(losses) on cash flow hedges			
Interest rate hedges	1.2	1.2	Interest expense
Cross-currency swaps	(0.5)	77.6	Interest income and other, net
Foreign currency hedges	(0.4)	1.3	Revenues
Foreign currency/coffee hedges	(7.1)	2.4	Cost of sales including occupancy costs
Gains/(losses) on net investment hedges	0.1	—	Interest income and other, net
Translation adjustment			
East China joint venture	(7.2)	—	Gain resulting from acquisition of joint venture
Taiwan joint venture	(1.4)	—	Gains resulting from divestiture of certain operations
Other	1.9	—	Interest income and other, net
	(15.1)	81.7	Total before tax
	0.8	(16.0)	Tax benefit
	$ (14.3)	$ 65.7	Net of tax

In addition to 2.4 billion shares of authorized common stock with $0.001 par value per share, the Company has authorized 7.5 million shares of preferred stock, none of which was outstanding as of December 31, 2017.

We repurchased 28.5 million shares of common stock at a total cost of $1.6 billion, and 7.6 million shares at a total cost of $413.7 million for the quarters ended December 31, 2017 and January 1, 2017, respectively. As of December 31, 2017, 51.8 million shares remained available for repurchase under current authorizations.

During the first quarter of fiscal 2018, our Board of Directors declared a quarterly cash dividend to shareholders of $0.30 per share to be paid on February 23, 2018 to shareholders of record as of the close of business on February 8, 2018.

Note 9: Employee Stock Plans

As of December 31, 2017, there were 58.6 million shares of common stock available for issuance pursuant to future equity-based compensation awards and 13.2 million shares available for issuance under our employee stock purchase plan.

Stock-based compensation expense recognized in the consolidated statements of earnings (in millions):

	Quarter Ended	
	Dec 31, 2017	Jan 1, 2017
Options	$14.2	$14.9
Restricted Stock Units (“RSUs”)	47.2	40.1
Total stock-based compensation expense	$61.4	$55.0

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Stock option and RSU transactions from October 1, 2017 through December 31, 2017 (in millions):

	Stock Options	RSUs
Options outstanding/Nonvested RSUs, October 1, 2017	31.4	7.6
Granted	3.6	5.8
Options exercised/RSUs vested	(2.5)	(2.8)
Forfeited/expired	(0.3)	(0.3)
Options outstanding/Nonvested RSUs, December 31, 2017	32.2	10.3
Total unrecognized stock-based compensation expense, net of estimated forfeitures, as of December 31, 2017	$ 49.8	$279.9

Note 10: Income Taxes

Our tax provision is determined using an estimated annual effective tax rate and adjusted for discrete taxable events that may occur during the quarter. We recognize the effects of tax legislation in the period in which the law is enacted. Our deferred tax assets and liabilities are remeasured using enacted tax rates expected to apply to taxable income in the years we estimate the related temporary differences to reverse.

On December 22, 2017, the President of the United States signed and enacted comprehensive tax legislation into law H.R. 1, commonly referred to as the Tax Cuts and Jobs Act (the “Tax Act”). Except for certain provisions, the Tax Act is effective for tax years beginning on or after January 1, 2018. As a fiscal year U.S. taxpayer, the majority of the provisions will apply to our fiscal 2019, such as eliminating the domestic manufacturing deduction, creating new taxes on certain foreign sourced income and introducing new limitations on certain business deductions. For fiscal 2018 and effective in the first fiscal quarter, the most significant impacts include: lowering of the U.S. federal corporate income tax rate; remeasuring certain net deferred tax liabilities; and requiring the transition tax on the deemed repatriation of certain foreign earnings. The phase in of the lower corporate income tax rate resulted in a blended rate of 24.5% for fiscal 2018, as compared to the previous 35%. The tax rate will be reduced to 21% in subsequent fiscal years. In the first quarter of fiscal 2018, we recorded $77 million net income tax benefit for the provisional remeasurement of certain deferred taxes and related amounts. Additionally, we recorded a provisional $212 million of income tax expense for the estimated effects of the transition tax, net of adjustments related to uncertain tax positions.

Based on our current interpretation of the Tax Act, we made reasonable estimates to record provisional adjustments during the first quarter of fiscal 2018, as described above. Collectively, these items did not have a material impact to our condensed consolidated financial statements. Since we are still accumulating and processing data to finalize the underlying calculations and expect regulators to issue further guidance, among other things, we believe our estimates may change during fiscal 2018. We continue to refine such amounts within the measurement period allowed, which will be completed no later than the first quarter of fiscal 2019.

Note 11: Earnings per Share

Calculation of net earnings per common share (“EPS”) — basic and diluted (in millions, except EPS):

	Quarter Ended	
	Dec 31, 2017	Jan 1, 2017
Net earnings attributable to Starbucks	$2,250.2	$751.8
Weighted average common shares outstanding (for basic calculation)	1,421.0	1,457.5
Dilutive effect of outstanding common stock options and RSUs	13.6	13.0
Weighted average common and common equivalent shares outstanding (for diluted calculation)	1,434.6	1,470.5
EPS — basic	$1.58	$0.52
EPS — diluted	$1.57	$0.51

Potential dilutive shares consist of the incremental common shares issuable upon the exercise of outstanding stock options (both vested and nonvested) and unvested RSUs, calculated using the treasury stock method. The calculation of dilutive shares outstanding excludes out-of-the-money stock options (i.e., such options’ exercise prices were greater than the average market price of our common shares for the period) because their inclusion would have been antidilutive. Out-of-the-money stock options totaled approximately 5.0 million and 8.6 million as of December 31,

2017 and January 1, 2017, respectively.

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Note 12: Segment Reporting

Our chief executive officer and executive chairman comprise the Company's Chief Operating Decision Maker function ("CODM"). Segment information is prepared on the same basis that our CODM manages the segments, evaluates financial results and makes key operating decisions.

The table below presents financial information for our reportable operating segments and All Other Segments (in millions):

Quarter Ended	Americas	China/ Asia Pacific	EMEA	Channel Development	All Other Segments	Segment Total
December 31, 2017						
Total net revenues	$4,265.8	$ 843.7	$283.9	$ 560.3	$ 120.0	$6,073.7
Depreciation and amortization expenses	158.0	53.7	7.7	0.5	0.7	220.6
Income from equity investees	—	50.7	—	38.7	—	89.4
Operating income/(loss)	979.4	196.8	39.1	243.3	(30.0)	1,428.6
January 1, 2017						
Total net revenues	$3,991.4	$ 770.8	$262.4	$ 553.7	$ 154.6	$5,732.9
Depreciation and amortization expenses	152.4	48.6	7.6	0.6	2.9	212.1
Income from equity investees	—	42.5	—	41.9	—	84.4
Operating income/(loss)	958.5	163.4	44.1	242.9	9.6	1,418.5

All Other Segments includes our Teavana business, and fiscal 2018 results reflect the strategy to close Teavana-branded retail stores announced in fiscal 2017 to focus on sales of premium Teavana™/MC tea products at Starbucks branded stores and, to a lesser extent, consumer product channels. The existing portfolio of Teavana stores are expected to be closed during fiscal 2018. Lease exit costs associated with our restructuring efforts will be recognized concurrently with either actual store closures or upon reaching a lease termination agreement with the landlord. Total lease exit costs are expected to be approximately $143.2 million of which $16.6 million and $0.0 million were recorded within restructuring expenses on the consolidated statement of earnings in the first quarter of 2018 and 2017, respectively. Previously recorded lease exit costs recorded within restructuring expenses for fiscal year 2017 were $15.7 million.

Reconciliation of total segment operating income to consolidated earnings before income taxes (in millions):

	Quarter Ended	
	Dec 31, 2017	Jan 1, 2017
Total segment operating income	$1,428.6	$1,418.5
Unallocated corporate operating expenses	(312.5)	(285.9)
Consolidated operating income	1,116.1	1,132.6
Gain resulting from acquisition of joint venture	1,326.3	—
Gains resulting from divestiture of certain operations	501.2	—
Interest income and other, net	88.2	24.1
Interest expense	(25.9)	(23.8)
Earnings before income taxes	$3,005.9	$1,132.9

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Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

CAUTIONARY STATEMENT PURSUANT TO THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

Certain statements herein, including statements regarding trends in or expectations relating to the expected effects of our initiatives and plans, as well as trends in or expectations regarding revenues, operating margins, comparable store sales, anticipated net new stores, the effects of foreign currency translation, the purchase of the remaining 50% ownership of our East China joint venture and other streamlining activities, earnings per share, tax rates, capital expenditures, sales leverage, other financial results, the health, strength and growth of our business overall and of specific businesses or markets, benefits of recent initiatives, investments in our business and partners, including our continued focus on operational excellence, product innovation and digital interactions with our customers, business opportunities and expansion, strategic acquisitions, expenses, dividends, share repurchases, commodity costs and our mitigation strategies, liquidity, cash flow from operations, use of cash and cash requirements, borrowing capacity and use of proceeds, repatriation of cash to the U.S., the potential issuance of debt and applicable interest rate, the expected effects of new accounting pronouncements and the estimated impact of changes in U.S. tax law, including on tax rates, and investments funded by these changes, 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, fluctuations in U.S. and international economies and currencies, our ability to preserve, grow and leverage our brands, potential negative effects of incidents involving food or beverage-borne illnesses, tampering, adulteration, contamination or mislabeling, potential negative effects of material breaches of our information technology systems to the extent we experience a material breach, material failures of our information technology systems, costs associated with, and the successful execution of, the company's initiatives and plans, including the integration of Starbucks Japan, the recently completed purchase of the remaining 50% ownership of our East China joint venture and the closure of Teavana stores, the acceptance of the company's products by our customers, the impact of competition, coffee, dairy and other raw materials prices and availability, the effect of legal proceedings, the effects of the Tax Cuts and Jobs Act and related guidance and regulations that may be promulgated, and other risks detailed in our filings with the SEC, including in Part I Item IA “Risk Factors” in the 10-K.

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

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

General

Our fiscal year ends on the Sunday closest to September 30. All references to store counts, including data for new store openings, are reported net of store closures, unless otherwise noted.

Overview

During the fourth quarter of fiscal 2017, Starbucks initiated streamlining efforts to focus on accelerating growth in high-returning businesses and remove non-core, slow growth activities. These efforts include acquisitions, divestitures and rationalizing portfolios of stores and products, among other things. The Company’s first quarter of fiscal 2018 reflects these and related restructuring activities, such as the acquisition of its East China joint venture, full conversion of the Singapore retail operations to licensed, ongoing closures of Teavana$^{TM/MC}$ retail stores and the sale of the Tazo brand, which primarily impacted CAP, Channel Development and All Other Segments.

Overall, Starbucks delivered solid growth in net revenues of 6% to $6.1 billion in its first quarter of fiscal 2018. This was primarily driven by incremental revenues from 2,305 net new store openings over the last 12 months and global comparable store sales growth of 2%. Consolidated operating income decreased $16.5 million, or 1%, to $1.1 billion. Operating margin declined 140 basis points to 18.4%, primarily due to a food-related mix shift in the Americas

segment and restructuring costs related to the certain streamlining efforts noted above, primarily the planned closure of our Teavana-branded retail stores in All Other Segments.

In December 2017, the U.S. government enacted comprehensive tax legislation into law H.R. 1, commonly referred to as the Tax Cuts and Jobs Act (the “Tax Act”), to reduce the U.S. federal corporate income tax rate and transition to a territorial from a worldwide tax system with deferral, among other changes. As a fiscal year taxpayer, the Company is not subject to the majority of the provisions until fiscal 2019. However, for its first quarter and full year fiscal 2018, the Company has applied a blended

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corporate income tax rate of 24.5% from the previous 35%, and remeasured its U.S. federal net deferred tax liabilities to the newly enacted tax rates. These estimated tax benefits were partially offset by the provisional amount recorded for the one-time repatriation tax on accumulated undistributed earnings of foreign subsidiaries and certain equity investments that are indefinitely reinvested. Collectively, the Tax Act did not materially affect the Company's net earnings during the quarter.

Earnings per share of $1.57 increased 208% over the prior year quarter earnings per share of $0.51. The results for the first quarter of fiscal 2018 included $0.79 related to the net gain from remeasuring our preexisting 50% ownership interest in our East China joint venture to fair value upon acquisition and $0.23 for other streamlining efforts, primarily the net gains from the divestitures of the Tazo brand and our Taiwan joint venture.

Americas revenue grew by 7% to $4.3 billion, primarily driven by incremental revenues from 979 net new store openings over the past 12 months and comparable store sales growth of 2%. Operating income increased $21 million and operating margin of 23.0% declined 100 basis points from a year ago, primarily due to a food-related mix shift.

In our China/Asia Pacific segment, revenues grew by 9% to $844 million, primarily driven by incremental revenues from 1,033 net new stores over the past 12 months and a 1% increase in comparable store sales. The increase was partially offset by the conversion of our Singapore retail business to fully licensed operations in the fourth quarter of fiscal 2017. Operating income grew 20% to $197 million, while operating margin expanded 210 basis points to 23.3%. The overall operating margin expansion was primarily due to sales leverage and favorable foreign currency translation.

In our EMEA segment, revenues increased $22 million, or 8%, primarily driven by favorable foreign currency translation and increased revenues from the opening of 365 net new licensed stores over the past 12 months. Partially offsetting the increase was a decrease in comparable store sales of 1%, which represents approximately 16% of the region's store portfolio. Operating margin declined 300 basis points to 13.8% primarily due to sales deleverage in our company-operated store portfolio.

Channel Development segment revenues grew by 1% to $560 million, primarily driven by higher foodservice, international and packaged coffee product sales, partially offset by lower revenues from competitive pricing on certain items. Operating income was flat and operating margin decreased 50 basis points to 43.4% in the first quarter of fiscal 2018 primarily due to deleverage on cost of sales and lower income from our North American Coffee Partnership joint venture, partially offset by lower marketing expenses.

Fiscal 2018 — Financial Outlook for the Year

For fiscal 2018, we expect consolidated revenue growth in the range of 9% to 11% when compared to fiscal 2017, with approximately 4% related to the acquisition of East China, offset by approximately 2% of other streamlining activities such as the sale of our Tazo brand and Taiwan joint venture, as well as the planned closure of our Teavana retail stores. Revenue growth for fiscal 2018 is expected to be driven by approximately 2,300 net new stores worldwide, comparable store sales and our continued focus on operational excellence, product innovation and enhancing our digital interactions with customers. Approximately 1,100 net new store openings will be in our China/Asia Pacific segment, approximately 900 net new stores coming from the Americas segment and the remaining store growth from the EMEA segment. Global comparable store sales growth for fiscal 2018 is expected to be near the low end of the targeted long-term 3% to 5% range.

Beginning in the second quarter of fiscal 2018, East China's operating results will be fully consolidated. While we expect significant revenue growth, the consolidated and CAP segment margins will decline for full fiscal year 2018. This is due to the change from a joint venture model to a company-operated model. Under the joint venture model, we recognized royalties and product sales within revenue and related product cost of goods sold as well as our proportionate share of East China's net earnings, which we recorded within income from equity investees. This resulted in higher operating margin. Under the company-operated model, East China's results are reflected in each income statement line item and therefore, the basis for its operating margin will be more consistent with our other company-operated markets. We will fully lap the transaction in the second quarter of fiscal 2019 and will begin reporting the comparable store sales growth as part of our China and CAP metrics after 13 months post acquisition in accordance with the Company's policy.

Earnings per share is expected to be in the range of $3.32 to $3.36 for full year fiscal 2018, which includes a $0.94 benefit from the East China acquisition gain, the largest portion of which was recognized in our first quarter of fiscal 2018. Revenue growth and sales leverage are expected to be partially offset by investments in our partners (employees) and digital innovations. Savings generated from the lower U.S. corporate income tax rate are expected to fund the Company's plans to increase returns to shareholders and accelerate certain investments.

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We expect our fiscal 2018 consolidated effective tax rate to be approximately 23%, which includes a 5% benefit from the primarily non-taxable East China acquisition gain and approximately 5% benefit from the enacted Tax Act. The benefit from the Tax Act included 2% of net expense related to the required transition tax partially offset by a benefit from remeasuring our net deferred tax liabilities. We continue to assess the effects of the Tax Act on our consolidated financial statements, and because of our ongoing assessment, the actual effective tax rate for fiscal 2018 may differ from our initial estimate, primarily due to changes in interpretations of the Tax Act, any legislative or regulatory actions to address questions that arise, any related changes in accounting standards, or any updates or changes to estimates the Company has utilized to calculate the impacts.

Comparable Store Sales

Starbucks comparable store sales for the first quarter of fiscal 2018:

	Quarter Ended Dec 31, 2017		
	Sales Growth	Change in Transactions	Change in Ticket
Consolidated	2%	—%	2%
Americas	2%	—%	2%
China/Asia Pacific	1%	1%	—%
EMEA[1]	(1)%	(4)%	3%

[1]Company-operated stores represent 16% of the EMEA segment store portfolio as of December 31, 2017.

Our comparable store sales represent the growth in revenues from Starbucks® company-operated stores open 13 months or longer. Comparable store sales exclude the effect of foreign currency translation. Refer to our Quarterly Store Data also included in Item 2 of Part I of this 10-Q, for additional information on our company-operated and licensed store portfolio.

Results of Operations (in millions)

Revenues

	Quarter Ended		
	Dec 31, 2017	Jan 1, 2017	% Change
Company-operated stores	$4,741.8	$4,469.3	6.1 %
Licensed stores	682.4	602.4	13.3
CPG, foodservice and other	649.5	661.2	(1.8)
Total net revenues	$6,073.7	$5,732.9	5.9 %

Quarter ended December 31, 2017 compared with quarter ended January 1, 2017

Total net revenues for the first quarter of fiscal 2018 increased $341 million compared to a year ago, primarily due to increased revenues from company-operated stores ($273 million). The growth in company-operated store revenues was driven by incremental revenues from 838 net new Starbucks® company-operated store openings over the past 12 months ($216 million) and a 2% increase in comparable store sales ($72 million), attributable to a 2% increase in average ticket. Also contributing was favorable foreign currency translation ($25 million), partially offset by the sale of our Singapore retail operations in the fourth quarter of fiscal 2017 ($31 million).

Licensed store revenue growth also contributed to the increase in total net revenues ($80 million), primarily due to increased product sales to and royalty revenues from our licensees ($74 million), largely due to the opening of 1,534 net new Starbucks® licensed stores over the past 12 months and improved comparable store sales, and favorable foreign currency translation ($7 million).

CPG (consumer packaged goods), foodservice and other revenues decreased $12 million, primarily driven by the absence of revenue from our e-commerce business ($19 million), lower revenues from competitive pricing on certain items ($8 million) and the absence of revenue from the sale of our Tazo brand late in the first quarter of fiscal 2018 ($7 million). Partially offsetting these decreases were higher foodservice sales ($10 million) and increased sales through our international channels, primarily associated with our Americas and European regions ($6 million).

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Operating Expenses

	Quarter Ended			
	Dec 31, 2017	Jan 1, 2017	Dec 31, 2017	Jan 1, 2017
			As a % of Total Net Revenues	
Cost of sales including occupancy costs	$2,502.9	$2,295.0	41.2%	40.0%
Store operating expenses	1,737.0	1,638.2	28.6	28.6
Other operating expenses	141.6	145.4	2.3	2.5
Depreciation and amortization expenses	258.8	249.7	4.3	4.4
General and administrative expenses	379.1	356.4	6.2	6.2
Restructuring expenses	27.6	—	0.5	—
Total operating expenses	5,047.0	4,684.7	83.1	81.7
Income from equity investees	89.4	84.4	1.5	1.5
Operating income	$1,116.1	$1,132.6	18.4%	19.8%
Store operating expenses as a % of company-operated store revenues			36.6%	36.7%
Other operating expenses as a % of non-company-operated store revenues			10.6%	11.5%

Quarter ended December 31, 2017 compared with quarter ended January 1, 2017

Cost of sales including occupancy costs as a percentage of total net revenues increased 120 basis points for the first quarter of fiscal 2018, primarily due to a food-related mix shift in the Americas segment (approximately 100 basis points).

Store operating expenses as a percentage of total net revenues were flat for the first quarter of fiscal 2018. Store operating expenses as a percentage of company-operated store revenues decreased 10 basis points.

Other operating expenses as a percentage of total revenues decreased 20 basis points for the first quarter of fiscal 2018. Other operating expenses as a percentage of non-retail revenues decreased 90 basis points, primarily driven by sales leverage (approximately 60 basis points) and lower marketing expenses (approximately 40 basis points).

General and administrative expenses as a percentage of total net revenues were flat.

Restructuring expenses negatively impacted our operating margin by 50 basis points, primarily due to restructuring costs related to the Company's ongoing efforts to streamline business operations. We recorded $25.9 million in restructuring costs related to the strategy to close our Teavana™/MC retail stores, including expenses associated with the early closure of stores and termination of agreements with franchisees. Additionally, we recorded $1.6 million in restructuring-related costs associated with the closure of certain North American Starbucks® company-operated stores.

Income from equity investees increased $5 million, primarily due to higher income from our CAP joint ventures.

The combination of these changes resulted in an overall decrease in operating margin of 140 basis points for the first quarter of fiscal 2018.

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Other Income and Expenses

	Quarter Ended			
	Dec 31, 2017	Jan 1, 2017	Dec 31, 2017	Jan 1, 2017
			As a % of Total Net Revenues	
Operating income	$1,116.1	$1,132.6	18.4 %	19.8 %
Gain resulting from acquisition of joint venture	1,326.3	—	21.8	—
Gains resulting from divestiture of certain operations	501.2	—	8.3	—
Interest income and other, net	88.2	24.1	1.5	0.4
Interest expense	(25.9)	(23.8)	(0.4)	(0.4)
Earnings before income taxes	3,005.9	1,132.9	49.5	19.8
Income tax expense	755.8	381.4	12.4	6.7
Net earnings including noncontrolling interests	2,250.1	751.5	37.0	13.1
Net earnings/(loss) attributable to noncontrolling interests	(0.1)	(0.3)	—	—
Net earnings attributable to Starbucks	$2,250.2	$751.8	37.0 %	13.1 %
Effective tax rate including noncontrolling interests			25.1 %	33.7 %

Quarter ended December 31, 2017 compared with quarter ended January 1, 2017

Gain resulting from acquisition of joint venture was due to remeasuring our preexisting 50% ownership interest in our East China joint venture to fair value upon acquisition.

Gains resulting from divestiture of certain operations primarily includes the gains on the sales of our Tazo brand and our Taiwan joint venture.

Net interest income and other increased $64 million primarily due to recognizing breakage income on unredeemed stored value card balances outside of the United States and Canada for the first time.

Interest expense increased $2 million primarily related to additional interest incurred on long-term debt issued in March 2017 and November 2017, partially offset by lower interest expense from the repayment of our December 2016 notes.

The effective tax rate for the quarter ended December 31, 2017 was 25.1% compared to 33.7% for the same quarter in fiscal 2017. The decrease was primarily due to the largely non-taxable gain on the purchase of our East China joint venture in the first quarter of fiscal 2018 (approximately 500 basis points) and due to the Tax Act (approximately 350 basis points). The impact from the Tax Act included favorability from the lower corporate income tax rate applied to our fiscal 2018 results (approximately 800 basis points) and the remeasurement of our net deferred tax liabilities (approximately 260 basis points). This favorability was partially offset by the estimated transition tax on our accumulated undistributed foreign earnings (approximately 710 basis points). See Note 10, Income Taxes, for further discussion.

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Segment Information

Results of operations by segment (in millions):

Americas

	Quarter Ended			
	Dec 31, 2017	Jan 1, 2017	Dec 31, 2017 As a % of Americas Total Net Revenues	Jan 1, 2017
Net revenues:				
Company-operated stores	$3,787.0	$3,561.0	88.8 %	89.2 %
Licensed stores	466.7	421.3	10.9	10.6
Foodservice and other	12.1	9.1	0.3	0.2
Total net revenues	4,265.8	3,991.4	100.0	100.0
Cost of sales including occupancy costs	1,603.8	1,440.3	37.6	36.1
Store operating expenses	1,433.4	1,356.3	33.6	34.0
Other operating expenses	37.5	31.9	0.9	0.8
Depreciation and amortization expenses	158.0	152.4	3.7	3.8
General and administrative expenses	52.1	52.0	1.2	1.3
Restructuring expenses	1.6	—	—	—
Total operating expenses	3,286.4	3,032.9	77.0	76.0
Operating income	$979.4	$958.5	23.0 %	24.0 %
Store operating expenses as a % of company-operated store revenues			37.9 %	38.1 %
Other operating expenses as a % of non-company-operated store revenues			7.8 %	7.4 %

Quarter ended December 31, 2017 compared with quarter ended January 1, 2017

Revenues

Americas total net revenues for the first quarter of fiscal 2018 increased $274 million, or 7%, primarily due to higher revenues from company-operated stores ($226 million) and licensed stores ($45 million).

The increase in company-operated store revenues was driven by incremental revenues from 420 net new Starbucks® company-operated store openings over the past 12 months ($143 million) and a 2% increase in comparable store sales ($67 million), primarily attributable to a 2% increase in average ticket.

The increase in licensed store revenues was driven by increased product sales to and royalty revenues from our licensees ($46 million), primarily resulting from the opening of 559 net new licensed stores over the past 12 months and improved comparable store sales.

Operating Expenses

Cost of sales including occupancy costs as a percentage of total net revenues increased 150 basis points for the first quarter of fiscal 2018, primarily due to a food-related mix shift (approximately 130 basis points).

Store operating expenses as a percentage of total net revenues decreased 40 basis points for the first quarter of fiscal 2018. Store operating expenses as a percentage of company-operated store revenues decreased 20 basis points, primarily driven by sales leverage (approximately 60 basis points).

Other operating expenses as a percentage of total revenues increased 10 basis points for the first quarter of fiscal 2018. Other operating expenses as a percentage of non-retail revenues increased 40 basis points, primarily due to a settlement related to Target Canada store closures received this quarter at a lower amount than the related settlement received in the prior year quarter (approximately 30 basis points). The settlement payments are being received over the course of the liquidation proceedings.

Restructuring expenses of $1.6 million were recorded associated with the early closure of certain North American Starbucks® company-operated stores and their related obligations in fiscal 2018.

The combination of these changes resulted in an overall decrease in operating margin of 100 basis points for the first quarter of fiscal 2018.

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China/Asia Pacific

	Quarter Ended			
	Dec 31, 2017	Jan 1, 2017	Dec 31, 2017	Jan 1, 2017
			As a % of CAP Total Net Revenues	
Net revenues:				
Company-operated stores	$742.5	$691.5	88.0 %	89.7 %
Licensed stores	98.4	78.0	11.7	10.1
Foodservice and other	2.8	1.3	0.3	0.2
Total net revenues	843.7	770.8	100.0	100.0
Cost of sales including occupancy costs	371.7	337.3	44.1	43.8
Store operating expenses	218.6	204.3	25.9	26.5
Other operating expenses	21.2	19.1	2.5	2.5
Depreciation and amortization expenses	53.7	48.6	6.4	6.3
General and administrative expenses	32.4	40.6	3.8	5.3
Total operating expenses	697.6	649.9	82.7	84.3
Income from equity investees	50.7	42.5	6.0	5.5
Operating income	$196.8	$163.4	23.3 %	21.2 %
Store operating expenses as a % of company-operated store revenues			29.4 %	29.5 %
Other operating expenses as a % of non-company-operated store revenues			20.9 %	24.1 %

Quarter ended December 31, 2017 compared with quarter ended January 1, 2017

Revenues

China/Asia Pacific total net revenues for the first quarter of fiscal 2018 increased $73 million, or 9% over the prior year period, primarily from higher company-operated store revenues ($51 million), driven by incremental revenues from 423 net new company-operated store openings over the past 12 months ($73 million) and a 1% increase in comparable store sales ($6 million), partially offset by the conversion to fully licensed operations as a result of selling our Singapore retail business in the fourth quarter of fiscal 2017 ($31 million).

Licensed store revenues increased $20 million due to increased product sales to and royalty revenues from licensees ($19 million), primarily resulting from the opening of 610 net new licensed stores over the past 12 months.

Operating Expenses

Store operating expenses as a percentage of total net revenues decreased 60 basis points for the first quarter of fiscal 2018. As a percentage of company-operated store revenues, store operating expenses decreased 10 basis points, primarily due to the absence of Singapore retail operations (approximately 10 basis points).

Other operating expenses as a percentage of total net revenues was flat for the first quarter of fiscal 2018. Excluding the impact of company-operated store revenues, other operating expenses decreased 320 basis points in the first quarter, primarily due to the timing of certain business taxes (approximately 240 basis points) and sales leverage.

General and administrative expenses as a percentage of total net revenues decreased 150 basis points for the first quarter of fiscal 2018, primarily due to sales leverage on salaries and benefits.

Income from equity investees increased $8 million due to higher income from our joint venture operations, primarily in China and South Korea and favorable foreign currency exchange. Favorability in both regions was attributable to comparable store sales growth and the addition of net new licensed stores over the past 12 months.

The combination of these changes and favorable foreign currency translation (approximately 90 basis points or $9 million) resulted in an overall increase in operating margin of 210 basis points for the first quarter of fiscal 2018.

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EMEA

	Quarter Ended			
	Dec 31, 2017	Jan 1, 2017	Dec 31, 2017 As a % of EMEA Total Net Revenues	Jan 1, 2017
Net revenues:				
Company-operated stores	$151.6	$145.9	53.4 %	55.6 %
Licensed stores	116.2	102.2	40.9	38.9
Foodservice	16.1	14.3	5.7	5.4
Total net revenues	283.9	262.4	100.0	100.0
Cost of sales including occupancy costs	152.1	136.1	53.6	51.9
Store operating expenses	54.7	46.9	19.3	17.9
Other operating expenses	16.3	16.0	5.7	6.1
Depreciation and amortization expenses	7.7	7.6	2.7	2.9
General and administrative expenses	14.0	11.7	4.9	4.5
Total operating expenses	244.8	218.3	86.2	83.2
Operating income	$39.1	$44.1	13.8 %	16.8 %
Store operating expenses as a % of company-operated store revenues			36.1 %	32.1 %
Other operating expenses as a % of non-company-operated store revenues			12.3 %	13.7 %

Quarter ended December 31, 2017 compared with quarter ended January 1, 2017

Revenues

EMEA total net revenues increased $22 million, or 8%, for the first quarter of fiscal 2018. The increase was primarily due to increased company-operated store revenues ($6 million) and driven by favorable foreign currency translation ($9 million), partially offset by a decrease in comparable store sales ($2 million).

Licensed store revenues increased $14 million, or 14%, due to higher product sales to and royalty revenues from our licensees ($8 million), primarily resulting from the opening of 365 net new licensed stores over the past 12 months, and favorable foreign currency translation ($5 million).

Operating Expenses

Cost of sales including occupancy costs as a percentage of total net revenues increased 170 basis points for the first quarter of fiscal 2018, primarily due to sales deleverage on company-operated stores (approximately 100 basis points) and unfavorable foreign currency exchange (approximately 80 basis points).

Store operating expenses as a percentage of total net revenues increased 140 basis points for the first quarter of fiscal 2018. As a percentage of company-operated store revenues, store operating expenses increased 400 basis points, primarily due to sales deleverage on salaries and benefits in certain company-operated stores, primarily due to increased minimum wage in certain markets.

Other operating expenses as a percentage of total net revenues decreased 40 basis points for the first quarter of fiscal 2018. Excluding the impact of company-operated store revenues, other operating expenses decreased 140 basis points, primarily due to sales leverage.

Depreciation and amortization expense as a percentage of total net revenue decreased 20 basis points, primarily due to the shift in the portfolio towards more licensed stores.

General and administrative expenses as a percentage of total net revenues increased 40 basis points, primarily due to higher salaries and benefits.

The combination of these changes resulted in an overall decrease in operating margin of 300 basis points for the first quarter of fiscal 2018.

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Channel Development

	Quarter Ended			
	Dec 31, 2017	Jan 1, 2017	Dec 31, 2017 As a % of Channel Development Total Net Revenues	Jan 1, 2017
Net revenues:				
CPG	$435.8	$437.1	77.8 %	78.9 %
Foodservice	124.5	116.6	22.2	21.1
Total net revenues	560.3	553.7	100.0	100.0
Cost of sales	296.3	288.5	52.9	52.1
Other operating expenses	55.6	60.4	9.9	10.9
Depreciation and amortization expenses	0.5	0.6	0.1	0.1
General and administrative expenses	3.3	3.2	0.6	0.6
Total operating expenses	355.7	352.7	63.5	63.7
Income from equity investees	38.7	41.9	6.9	7.6
Operating income	$243.3	$242.9	43.4 %	43.9 %

Quarter ended December 31, 2017 compared with quarter ended January 1, 2017

Revenues

Channel Development total net revenues for the first quarter of fiscal 2018 increased $7 million or 1% when compared to the prior year period primarily driven by our foodservice, international and packaged coffee channels ($17 million), partially offset by competitive pricing on certain items ($8 million) and the absence of revenue from the sale of our Tazo brand late in the first quarter of fiscal 2018 ($7 million).

Operating Expenses

Cost of sales as a percentage of total net revenues increased 80 basis points for the first quarter, primarily driven by deleverage on cost of sales (approximately 90 basis points).

Other operating expenses as a percentage of total net revenues decreased 100 basis points, primarily driven by lower marketing expenses (approximately 80 basis points).

Income from equity investees decreased $3 million due to lower income from our North American Coffee Partnership joint venture, primarily driven by decreased sales of both Frappuccino® and Iced Coffee beverages.

The combination of these changes resulted in an overall decrease in operating margin of 50 basis points for the first quarter of fiscal 2018.

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All Other Segments

	Quarter Ended		
	Dec 31, 2017	Jan 1, 2017	% Change
Net revenues:			
Company-operated stores	$60.7	$70.9	(14.4)%
Licensed stores	1.1	0.9	22.2
CPG, foodservice and other	58.2	82.8	(29.7)
Total net revenues	120.0	154.6	(22.4)
Cost of sales including occupancy costs	79.1	90.4	(12.5)
Store operating expenses	30.3	30.7	(1.3)
Other operating expenses	11.2	17.5	(36.0)
Depreciation and amortization expenses	0.7	2.9	(75.9)
General and administrative expenses	2.7	3.5	(22.9)
Restructuring expenses	26.0	—	nm
Total operating expenses	150.0	145.0	3.4
Operating income/ (loss)	$(30.0)	$9.6	nm

All Other Segments primarily includes Teavana-branded stores, Seattle's Best Coffee, as well as Starbucks Reserve® and Roastery businesses. The operating loss was primarily due to restructuring costs related to our strategy to close Teavana™/MC retail stores and focus on Teavana within the Starbucks® stores. We recorded $25.9 million in restructuring-related costs, including expenses associated with the early closure of stores and termination of agreements with franchisees.

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Quarterly Store Data

Our store data for the periods presented is as follows:

	Net stores opened/(closed) and transferred during the period		Stores open as of	
	Quarter Ended			
	Dec 31, 2017	Jan 1, 2017	Dec 31, 2017	Jan 1, 2017
Americas				
Company-operated stores	112	75	9,525	9,094
Licensed stores	166	176	7,312	6,764
Total Americas	278	251	16,837	15,858
China/Asia Pacific [1]				
Company-operated stores	1,612	104	4,682	2,915
Licensed stores	(1,312)	199	3,097	3,831
Total China/Asia Pacific	300	303	7,779	6,746
EMEA				
Company-operated stores	1	(18)	503	505
Licensed stores	122	113	2,594	2,232
Total EMEA	123	95	3,097	2,737
All Other Segments [2]				
Company-operated stores	(1)	(2)	289	356
Licensed stores	—	2	37	37
Total All Other Segments	(1)	—	326	393
Total Company	700	649	28,039	25,734

[1] China/Asia Pacific store data includes the transfer of 1,477 licensed stores in East China to company-operated retail stores as a result of the purchase of our East China joint venture in the first quarter of fiscal 2018.

[2] As of December 31, 2017, All Other Segments included 323 Teavana-branded stores, of which 286 stores were company-operated.

Financial Condition, Liquidity and Capital Resources

Investment Overview

Our cash and investments totaled $4.1 billion as of December 31, 2017 and $3.2 billion as of October 1, 2017. We actively manage our cash and investments in order to internally fund operating needs, make scheduled interest and principal payments on our borrowings, make acquisitions, and return cash to shareholders through common stock cash dividend payments and share repurchases. Our investment portfolio primarily includes highly liquid available-for-sale securities, including corporate debt securities, government treasury securities (foreign and domestic), mortgage and asset-backed securities and agency obligations. As of December 31, 2017, approximately $2.5 billion of our cash and investments were held in foreign subsidiaries.

Borrowing Capacity

Our $2.0 billion unsecured 5-year revolving credit facility (the “2018 credit facility”) and our $1.0 billion unsecured 364-Day credit facility (the “364-day credit facility”) are available for working capital, capital expenditures and other corporate purposes, including acquisitions and share repurchases.

The 2018 credit facility, of which $150 million may be used for issuances of letters of credit, is currently set to mature on October 25, 2022. We have the option, subject to negotiation and agreement with the related banks, to increase the maximum commitment amount by an additional $500 million. Borrowings under the credit facility will bear interest at a variable rate based on LIBOR, and, for U.S. dollar-denominated loans under certain circumstances, a Base Rate (as

defined in the credit facility), in each case plus an applicable margin. The applicable margin is based on the better of (i) the Company's long-term credit ratings assigned by Moody's and Standard & Poor's rating agencies and (ii) the Company's fixed charge coverage ratio, pursuant to a pricing grid set forth in the five-year credit agreement. The current applicable margin is 0.910% for Eurocurrency Rate Loans and 0.00% (nil) for Base Rate Loans.

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The 364-day credit facility, of which no amount may be used for issuances of letters of credit, is currently set to mature on October 25, 2018. We have the option, subject to negotiation and agreement with the related banks, to increase the maximum commitment amount by an additional $500 million. Borrowings under the credit facility will bear interest at a variable rate based on LIBOR, and, for U.S. dollar-denominated loans under certain circumstances, a Base Rate (as defined in the credit facility), in each case plus an applicable margin. The applicable margin is 0.585% for Eurocurrency Rate Loans and 0.00% (nil) for Base Rate Loans.

Both credit facilities contain provisions requiring us to maintain compliance with certain covenants, including a minimum fixed charge coverage ratio, which measures our ability to cover financing expenses. As of December 31, 2017, we were in compliance with all applicable credit facility covenants.

Under our commercial paper program, we may issue unsecured commercial paper notes up to a maximum aggregate amount outstanding at any time of $3 billion, with individual maturities that may vary but not exceed 397 days from the date of issue. Amounts outstanding under the commercial paper program are required to be backstopped by available commitments under our credit facility discussed above. The proceeds from borrowings under our commercial paper program may be used for working capital needs, capital expenditures and other corporate purposes, including, but not limited to, business expansion, payment of cash dividends on our common stock and share repurchases. As of December 31, 2017, we had no outstanding borrowings under the program.

The indentures under which all of our Senior Notes were issued, as detailed in Note 7, Debt, to the condensed consolidated financial statements included in Item 1 of Part I of this 10-Q, require us to maintain compliance with certain covenants, including limits on future liens and sale and leaseback transactions on certain material properties. As of December 31, 2017, we were in compliance with all applicable covenants.

On November 22, 2017, we issued long-term debt in an underwritten registered public offering, which consisted of $500 million of 3-year 2.200% Senior Notes (the “2020 notes”) due November 2020 and $500 million of 30-year 3.750% Senior Notes (the “2047 notes”) due December 2047. We will use the net proceeds from the offering for general corporate purposes, including repurchases of Starbucks common stock under our ongoing share repurchase program and payment of dividends. Interest on the 2020 notes is payable semi-annually on May 22 and November 22, commencing on May 22, 2018 and interest on the 2047 notes is payable semi-annually on June 1 and December 1, commencing on June 1, 2018. See Note 7, Debt, to the condensed consolidated financial statements included in Item 1 of Part I of this 10-Q for details of the components of our long-term debt.

Use of Cash

We expect to use our available cash and investments, including, but not limited to, additional potential future borrowings under the credit facilities, commercial paper program and the issuance of debt, to invest in our core businesses, including capital expenditures, new product innovations, related marketing support and partner and digital investments, return cash to shareholders through common stock cash dividend payments and share repurchases, as well as other new business opportunities related to our core and developing businesses such as Siren Retail. Further, we may use our available cash resources to make proportionate capital contributions to our investees. We may also seek strategic acquisitions to leverage existing capabilities and further build our business in support of our growth agenda. Acquisitions may include increasing our ownership interests in our investees. Any decisions to increase such ownership interests will be driven by valuation and fit with our ownership strategy. On December 31, 2017, we acquired the remaining 50% interest of our East China joint venture for approximately $1.4 billion in the form of a payable to UPG. Approximately $1.3 billion had been settled as of the date of this filing, primarily through the use of cash and investments held in foreign subsidiaries.

We believe that future cash flows generated from operations and existing cash and investments both domestically and internationally combined with our ability to leverage our balance sheet through the issuance of debt will be sufficient to finance capital requirements for our core businesses as well as shareholder distributions for the foreseeable future. Significant new joint ventures, acquisitions and/or other new business opportunities may require additional outside funding. We have borrowed funds and continue to believe we have the ability to do so at reasonable interest rates; however, additional borrowings would result in increased interest expense in the future.

We consider the majority of undistributed earnings of our foreign subsidiaries and equity investees as of December 31, 2017 to be indefinitely reinvested and, accordingly no foreign withholding taxes have been provided on such

earnings. We have not, nor do we anticipate the need for, repatriated funds to the U.S. to satisfy domestic liquidity needs. However, the Tax Act requires a one-time transition tax for deemed repatriation of accumulated undistributed earnings of certain foreign investments. This one-time transition tax is payable over eight years, with most of the cash outlay expected to be made in the later years. In connection with our initial analysis, we have estimated a provisional amount of $241 million, of which $233 million of income taxes payable was included in other long-term liabilities on the condensed consolidated balance sheet, as of December 31, 2017. See Note 10, Income Taxes, for further discussion.

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We regularly review our cash positions and our determination of permanent reinvestment of foreign earnings. In the event we determine that all or a portion of such foreign earnings are no longer indefinitely reinvested, we may be subject to additional foreign withholding taxes and U.S. state income taxes, beyond the Tax Act's one-time transition tax, which could be material. We do not believe it is practicable to calculate the amount of unrecognized deferred income taxes as there is a significant amount of uncertainty around the calculation.

During the first quarter of fiscal 2018, our Board of Directors declared a quarterly cash dividend to shareholders of $0.30 per share to be paid on February 23, 2018 to shareholders of record as of the close of business on February 8, 2018.

We repurchased 28.5 million shares of common stock, or $1.6 billion, during the first quarter of fiscal 2018 under our ongoing share repurchase program. The number of remaining shares authorized for repurchase as of December 31, 2017 totaled 51.8 million.

Other than normal operating expenses, cash requirements for the remainder of fiscal 2018 are expected to consist primarily of capital expenditures for investments in our new and existing stores, our developing Siren Retail business and our supply chain and corporate facilities. Total capital expenditures for fiscal 2018 are expected to be approximately $2 billion.

Cash Flows

Cash provided by operating activities was $1.8 billion for the first quarter of fiscal 2018, compared to $1.5 billion for the same period in fiscal 2017. The change was primarily due to increased earnings.

Cash provided by investing activities for the first quarter of fiscal 2018 totaled $395 million, compared to cash used by investing activities of $402 million for the same period in fiscal 2017. The change was primarily due to proceeds from the sale of Tazo and lower purchases of investments.

Cash used by financing activities for the first quarter of fiscal 2018 totaled $1.0 billion, compared to $1.2 billion for the same period in fiscal 2017. The change was primarily due to higher proceeds from issuances of long-term debt, lapping the repayment of the 2016 notes, partially offset by an increase in share repurchases.

Contractual Obligations

In Management’s Discussion and Analysis of Financial Condition and Results of Operations included in the 10-K, we disclosed that we had $14.9 billion in total contractual obligations as of October 1, 2017. Other than the issuance of our 2020 notes and our 2047 notes and the payable related to the acquisition of East China in the first quarter of fiscal 2018, as described in Note 7, Debt, and Note 2, Acquisitions and Divestitures, respectively to the condensed consolidated financial statements included in Item 1 of Part I of this 10-Q, there have been no material changes to our total obligations during the period covered by this 10-Q outside of the normal course of our business. Approximately $1.3 billion of the East China payable has been settled as of the date of this filing.

Off-Balance Sheet Arrangements

There has been no material change in our off-balance sheet arrangements discussed in Management’s Discussion and Analysis of Financial Condition and Results of Operations included in the 10-K.

Commodity Prices, Availability and General Risk Conditions

Commodity price risk represents our primary market risk, generated by our purchases of green coffee and dairy products, among other items. We purchase, roast and sell high-quality arabica coffee and related products and risk arises from the price volatility of green coffee. In addition to coffee, we also purchase significant amounts of dairy products to support the needs of our company-operated stores. The price and availability of these commodities directly impact our results of operations, and we expect commodity prices, particularly coffee, to impact future results of operations. For additional details, see Product Supply in Item 1 of the 10-K, as well as Risk Factors in Item 1A of the 10-K.

Seasonality and Quarterly Results

Our business is subject to moderate seasonal fluctuations, of which our fiscal second quarter typically experiences lower revenues and operating income. Additionally, as Starbucks Cards are issued to and loaded by customers during the holiday season, we tend to have higher cash flows from operations during the first quarter of the fiscal year. However, since revenues from Starbucks Cards are recognized upon redemption and not when cash is loaded onto the Card, the impact of seasonal fluctuations on the consolidated statements of earnings is much less pronounced. As a

result of moderate seasonal fluctuations, results for any quarter are not necessarily indicative of the results that may be achieved for the full fiscal year.

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RECENT ACCOUNTING PRONOUNCEMENTS

See Note 1, Summary of Significant Accounting Policies, to the condensed consolidated financial statements included in Item 1 of Part I of this 10-Q, for a detailed description of recent accounting pronouncements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

There has been no material change in the commodity price risk, foreign currency exchange risk, equity security price risk or interest rate risk discussed in Item 7A of the 10-K.

Item 4. Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that material information required to be disclosed in our periodic reports filed or submitted under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Our disclosure controls and procedures are also designed to ensure that information required to be disclosed in the reports we file or submit under the Exchange Act is accumulated and communicated to our management, including our principal executive officer and principal financial officer as appropriate, to allow timely decisions regarding required disclosure.

During the first quarter of fiscal 2018, we carried out an evaluation, under the supervision and with the participation of our management, including our chief executive officer and our chief financial officer, of the effectiveness of the design and operation of the disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act. Based upon that evaluation, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures were effective, as of the end of the period covered by this report (December 31, 2017).

There were no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act) during our most recently completed fiscal quarter that materially affected or are reasonably likely to materially affect internal control over financial reporting.

The certifications required by Section 302 of the Sarbanes-Oxley Act of 2002 are filed as exhibits 31.1 and 31.2 to this 10-Q.

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PART II — OTHER INFORMATION

Item 1. Legal Proceedings

Starbucks is party to various legal proceedings arising in the ordinary course of business, including, at times, certain employment litigation cases that have been certified as class or collective actions, but is not currently a party to any legal proceeding that management believes could have a material adverse effect on our consolidated financial position, results of operations or cash flows.

Item 1A. Risk Factors

There have been no material changes to the risk factors previously disclosed in the 10-K.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Information regarding repurchases of our common stock during the quarter ended December 31, 2017:

Period[1]	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs[2]	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
October 2, 2017 — October 29, 2017	4,853,039	$ 54.58	4,853,039	75,464,372
October 30, 2017 — November 26, 2017	11,661,314	56.82	11,661,314	63,803,058
November 27, 2017 — December 31, 2017	11,959,889	57.75	11,959,889	51,843,169
Total	28,474,242	$ 56.83	28,474,242	

(1) Monthly information is presented by reference to our fiscal months during the first quarter of fiscal 2018.

(2) Share repurchases are conducted under our ongoing share repurchase program announced in September 2001, which has no expiration date.

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Item 6. Exhibits

Exhibit No.	Exhibit Description	Incorporated by Reference Form	File No.	Date of Filing	Exhibit Number	Filed Herewith
3.1	Restated Articles of Incorporation of Starbucks Corporation	10-Q	0-20322	4/28/2015	3.1	
3.2	Amended and Restated Bylaws of Starbucks Corporation (As amended and restated through September 13, 2016)	8-K	0-20322	9/16/2016	3.1	
4.1	Second Supplemental Indenture, dated as of November 22, 2017, by and between Starbucks Corporation and U.S. Bank National Association, as trustee	8-K	0-20322	11/22/2017	4.2	
4.2	Form of 2.200% Senior Notes due November 22, 2020	8-K	0-20322	11/22/2017	4.3	
4.3	Form of 3.750% Senior Notes due December 1, 2047	8-K	0-20322	11/22/2017	4.4	
10.1	Credit Agreement, dated October 25, 2017, among Starbucks Corporation, Bank of America, N.A., in its capacity as Administrative Agent, Swing Line Lender and L/C Issuer, Wells Fargo Bank, N.A., Citibank, N.A. and U.S. Bank National Association, as L/C Issuers, and the other Lenders from time to time a party thereto.	8-K	0-20322	10/30/2017	10.1	
10.2	364-Day Credit Agreement, dated October 25, 2017, among Starbucks Corporation, Bank of America, N.A., in its capacity as Administrative Agent and Swing Line Lender, and the other Lenders from time to time a party thereto.	8-K	0-20322	10/30/2017	10.2	
31.1	Certification of Principal Executive Officer Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, As Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	—	—	—	—	X
31.2	Certification of Principal Financial Officer Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, As Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	—	—	—	—	X
32*	Certifications of Principal Executive Officer and Principal Financial Officer Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	—	—	—	—	—
101	The following financial statements from the Company's 10-Q for the fiscal quarter ended December 31, 2017, formatted in XBRL: (i) Condensed Consolidated Statements of Earnings, (ii) Condensed Consolidated Statements of Comprehensive Income, (iii) Condensed Consolidated Balance Sheets, (iv) Condensed Consolidated Statements of Cash Flows and (v) Notes to Condensed Consolidated Financial Statements	—	—	—	—	X

* Furnished herewith.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

January 31, 2018

STARBUCKS CORPORATION

By: /s/ Scott Maw
Scott Maw
executive vice president, chief financial officer
Signing on behalf of the registrant and as
principal financial officer