Strategic Report for Peet's Coffee & Tea

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Executive Summary

Peet's Coffee & Tea is a specialty coffee roaster and marketer of fresh roasted whole bean coffee and tea. Founded in Berkeley, California in 1966, Peet's has established a loyal customer base with strong brand awareness in California. Their coffee is sold under multiple channels of distribution including grocery stores, home delivery, office, restaurant and foodservice accounts and Company-owned and operated stores in six states. This creates two different reportable segments of retail stores and specialty sales. As of December 2008 Peet's operates 188 retail stores and is available in approximately 8,500 grocery stores. Consumer specialty sales represent 33% of sales and 69% of total profit. Retail sales represent 67% of total sales but only 31% of total profits.

In 2008, the Company continued to pursue its strategy to expand its multiple distribution channels in the United States. Their first priority seemed to be developing primarily in the western US markets where they already have established a presence and customer awareness. The efforts of the 2008 distribution expansion include: opening 23 new retail stores, 22 of which were in California and entering 2,400 new grocery stores primarily outside of the western core, which helped grow grocery store revenue by 23%. In the long term, Peet's Coffee should continue to open new retail stores in strategic west coast locations and in grocery, they should continue to expand into new markets, as Peet's specialty sales can penetrate markets where there is no retail presence. Once they have this brand name presence in outside areas, they can look into opening more retail stores in these locations.

The US coffee industry is very large, a market of approximately $27 billion, and specialty coffee accounts for $11-12 billion of this. The growth in specialty coffee is particularly strong in grocery where specialty coffee dollars spent in the last year grew an estimated 12%. This market generates most of its sales from coffeehouses that currently number over 20,000 in the United States. The specialty coffee category is highly competitive, but is mostly dominated by Starbucks Corporation, which is larger than all the competitors combined. In the coffeehouse business, Peet's also competes with small single unit mom and pop coffeehouses and local chains such as, Coffee Bean & Tea Leaf, Tully's and Caribou Coffee.

Outside of the coffeehouse business, which is the specialty segment, Peet's main competitors are Green Mountain Coffee, Illy Caffé, Tully's and Dunkin' Donuts. To a lesser extent, Peet's Coffee also competes with more mainstream coffee such as Maxwell House and Folger's. Part of Peet's strategy needs to be differentiating the company from these mass of competitors. They should try to sell themselves as a joyful coffee buying experience in order to achieve this. Also, focusing their business in particular channels of distribution, such as grocery, would help their brand awareness in these particular areas.

The current recession or a worsening of the United States and global economy could materially adversely affect Peet's business as their revenues based on expensive specialty coffee depend significantly on consumer confidence and spending. In 2009, Peet's primary focus should be on strengthening the core of their existing businesses. As a result, they are only opening 10 new stores in 2009, versus 23 in 2008, and expect to gain distribution in approximately 1,000 new grocery stores, versus the 2,400 they added in 2008. They should also look into analyzing the profitability and growth of all of their existing stores to see if some need to be cut from their business

Company Overview

History

Peet's Coffee and Tea is a specialty coffee roaster and retailer founded by Alfred Peet in 1966. Peet, who earned the nickname the "grandfather of gourmet coffee," worked in the coffee trade in his native country of Holland before moving to the US after WWII. His dissatisfaction with American coffee inspired him to begin brewing his own coffee—starting with his first store in Berkeley, California.

Two major factors differentiated Peet's Coffee from the contemporary competition. The first was his emphasis on brewing smaller batches of coffee—made up of top notch beans—in order to preserve freshness. Second, he utilized a darker roasting style that resulted in coffee that was richer and more complex than most coffee offered at the time. These innovations paid dividends long before the company went public. In just a few years his coffee had gained quite a rabid fan base. Regular patrons to the store became known as "Peetniks," and the first store attracted such a variety of other gourmet food purveyors to the neighborhood that the area earned the title of the "Gourmet Ghetto."

While the first store attracted a loyal crowd, a second store did not open until five years later and another four years until the third store opened. Perhaps it was the distinct taste that some described as "burnt" that prevented the immediate expansion of the brand. Or, maybe it was just Alfred Peet's nature to nurture his baby along, and ensure that freshness was more important than revenues. One example of his refusal to serve stale coffee is the fact that Peet's coffee beans and teas were never vacuum-packed and were shipped within 24 hours of being roasted to order. In the store, coffee was made fresh every half hour, and no beans were allowed to stand for more than seven days.

Of course, Peet's success prompted others to attempt a similar style of coffee shop. In fact, the three founders of the now ubiquitous Starbucks chain knew Peet personally, and started a parallel specialty coffee shop in Seattle, Washington in 1971. In their first year of operation, the Starbucks' founders actually bought their coffee beans from Peet's Coffee. The relationship between the two companies doesn't end there, though. In 1984, one of the Starbucks' founders, Jerry Baldwin, and an associate who was to become the "roastmaster," joined with a group of investors to buy Peet's four bay area locations. In 1987, these owners decided to sell Starbucks (to the now famous Howard Schultz) to focus on managing Peet's.

Unlike its copycat and now much larger rival, Peet's has not grown at a rapid clip. Throughout the late '80s and early '90s, Peet's gradually increased the number of stores by just a couple every year. Peet's growth picked up somewhat in 1994 after the company received a $6 million private placement from the San Francisco investment firm Hambrecht & Quist. The funds enabled Peet's to open a 60,000-square-foot roastery in Emeryville, California, which had the capacity to supply 150 stores. Stores at this time and throughout the remainder of the 1990s averaged $1.2 million in sales annually. Each store cost approximately $350,000 to $400,000 to open, outfit, and decorate in the company's coffee-inspired colors, but each location was run independently by its manager and reflected the style of the neighborhood in which it was located.

By 1996, sales at Peet's approximately 30 stores, which by then sold coffee, tea, scones, and muffins, and a variety of brewing accessories and equipment, totaled about $40 million. In comparison, Starbucks brought in $696.5 million from its more than 1,100 stores in the United States, Canada, Japan, and Singapore. The two didn't have an intense rivalry, though; instead, each viewed the other as a friendly competitor serving somewhat different customer bases. In fact, their amiable relationship was foreshadowed in 1987 when the two signed a no-compete clause in the bay area.

By January of 2001, Peet's decided it needed a cash injection in order to spur further growth. The company went public on the NASDAQ (PEET) and raised $24.6 million in the process. On the first day of trading, shares rose 17 percent. This kick start enabled the company to continue expanding. Today, the firm has approximately 200 stores, mostly concentrated in California. Yet, a large and hitherto ignored aspect of the company today is Peet's presence in grocery stores. As of March, 2008, Peet's Coffee sold its beans in almost 6000 grocery stores such as Whole Foods and Safeway.

Business Model

Peet's prides itself on offering a high quality and freshness by tasting and picking the best beans from around the world, roasting by hand in its artisan facility, only roasting enough for the day's orders, and immediate delivery upon roasting. Peet's elite group of roasters each has a 10 year commitment and are not considered masters in their craft until 3 years of training. All of Peet's Coffee roasting happens in their newly opened facility in Alameda, California. It was developed with a LEED (Leadership in Energy and Environmental Design) approach in all areas of design and construction.

The company reports its business in two separate segments of sales: retail and specialty. The retail stores accounted for 67.5% of sales while specialty sales segment accounted for 32.5%. Currently Peet's Coffee operates 188 retail sores in six states, 140 of which are in California. The other states are Colorado, Illinois, Massachusetts, Oregon, and Washington. The specialty segment is divided into home delivery, grocery stores, restaurant and foodservice companies, and office accounts. Peet's main competitors are Farmer Bros. Co., Green

Mountain Coffee Roasters, Inc, Kraft Foods, Inc., Procter & Gamble Company, and Starbucks Company.

In its stores, Peet's ensures the brewing of coffee every 30 minutes, using beans only within 10 days of roasting, and never re-steaming their milk. Peet's Coffee and Tea has attracted a large group of loyal followers who name themselves "Peetnicks." The original Peetnicks were devotees at the first store on Vine Street, but the term has now evolved to represent any customer that is passionate about quality coffee and tea. Peet's Coffee offers many different signature blends including: Arabian Mocha-Java, Major Dickason's Blend, House Blend, French Roast, Gaia Organic Blend, Anniversary Blend, Espresso Forte, Sumatra, Garuda Blend, and Fair Trade Blend. Peet's Coffee stores offer a coffee of the day, café au lait, iced coffee, Peet's to go, espresso drinks, iced tea, tea bags, loose leaf tea, blended drinks, and baked goods. Peet's stores also provide free wireless internet for 2 hours for its customers.

Peet's also has its coffee available in grocery stores around the country although still mainly concentrated in California. In the Bay Area, Peet's has 45.9% of the market share of specialty coffee. It has recently added its products in grocery locations in Florida, New York, and South Carolina. Peet's Coffee bags its beans within an hour of roasting and then personally delivered to the grocery store. The company has now developed a Direct Store Delivery (DSD) distribution to cater to delivery customers. Grocery stores that provide Peet's coffee include Albertson's, Von's, Ralph's, Whole Food's, Safeway, Sprout's, Smith's, Raley's, and Kroger. Peet's most popular sold blends in grocery stores are Major Dickason's Blend, Decaf Major Dickason's Blend, French Roast, Decaf French Roast, House Blend, and Decaf House Blend.

Peet's also offers special office coffee program for small and large businesses. For these businesses, they provide their fresh coffee and thermal brewing equipment. Office perks include free shipping with a monthly ongoing recurring order of 6 or more pounds of Peet's. Peet's can also be easily ordered for regularly scheduled delivery on their website, www.peets.com. In the foodservice and office segment, the company works to expand its account base and distribution of its products through licensing and "we proudly brew"

(WPB) accounts. In WPB accounts the company supplies equipment and products to brew and sell. In licensing accounts, the company licenses a Peet's store in another location such as an airport or college campus.

Other Peet's perks include Peetniks membership for customers with recurring business orders. As long as a customer has an active ongoing delivery order, they receive 50% shipping discount, 100% satisfaction guarantee, a phone number of their own to manage their deliveries, and ability to manage their order online. The website also now has a special offering for customers that join Peetniks get a free pound of Anniversary Blend coffee. The Peetniks membership comes with two different recurring delivery options: same item, in which the customer receives the same item every time, and different items, in which the customer chooses a variety of coffees to be sent in different shipments. Peet's office coffee also offers a similar choice between same item delivery or custom item delivery. Peet's also has special advantages given in the Peet's card, a re-loadable debit card that can be used at any Peet's store or with online purchases. The card can also be purchased as a gift along with the electronic gift certificates that go directly to the recipient's email inbox.

Competitive Analysis

FORCE	STRATEGIC SIGNIFICANCE
Internal Rivalry	High
Supplier Power	Low
Buyer Power	Low
Entry and Exit	Medium
Substitutes	High
Complements	Medium

Internal Rivalry

There is much rivalry in the specialty coffee industry, but instead of price it tends to depend more on quality and elitism especially with its high-end customers. With coffee becoming such a staple in the average American diet, price matters less as people are willing to pay for their daily coffee, especially in retail stores.

Peet's market share in specialty coffee is constantly under pressure. In retail coffee, Peet's has many rivals including small local "mom and pop" stores. These stores can offer a similar experience of premium coffee and a comfortable environment. Coffeehouses are now becoming ubiquitous in America society, creating more competition for Peet's coffee stores. Although these small coffeehouses do not compete with Peet's on a national level, local competition can reduce profit margins since they appeal to many of the same consumers. Grocery sales are different because there is a great price difference between instant and specialty coffees, which are both offered at most stores. It is also much easier for consumers to directly compare prices when they have many options directly available to them.

Peet's rivalry can also be thought of regionally. In the west coast, its main competitor is Coffee Bean & Tea Leaf, but nationally Peet's competes with Starbucks, Green Mountain, Dunkin Donuts, McDonalds, and other fast food stores now offering coffee. Starbucks can be considered to be the natural leader in the specialty coffee industry, but their role appears to be changing from an elite company to a fast food chain. Now Starbucks find themselves competing more with McDonald's. This leaves a gap in the specialty coffee industry that Peet's and other coffee producers have attempted to fill. In the specialty coffee industry for some "elite" coffee drinkers there can be high product differentiation. In other words, these people have strict opinions about the best coffee, developing a reputation. More and more people are trying to become elite in their coffee tastes since it is viewed as popular in modern culture.

However, for the majority of people in today's economy, a price change in coffee can significantly change their brand preference, especially if they haven't formed a loyalty to a specific brand. Since coffee production has low marginal costs, it can be easy for producers to cut their prices to create more coffee sales. This is currently what Starbucks is trying to do. However, this can be dangerous for the company, and can cause competitive price cuts throughout the industry. Thus there is much internal competition that comes from the specialty coffee market due mostly to the large diversity and number of stores.

Supplier Power

Suppliers are rather limited in their location and capabilities in the specialty coffee market. Peet's Coffee must pursue contracts with farmers, transporters, and brewers for their inputs of coffee beans and milk. These input markets have their prices determined by supply and demand. So if the price of inputs changes, Peet's can substitute to another supplier because of the competitive nature of the market. However, this is more unlikely since Peet's already has built a relationship and reputation especially with their expert brewers and farmers, since the company prides itself on its quality. It is most likely that Peet's will not break the contracts it has, but with significant changes in prices, it is a possibility. Thus Peet's has most of the power in this market.

Buyer Power

The price at which Peet's sells their coffee is based upon the price elasticity of demand and other competitor's prices. Since Peet's reputation is based on quality, they are able to sell at a higher price than most rivals, but they still like to keep their coffee to be considered affordable. Many times buyers have their own favorite coffee due to taste preferences and availability. This makes it less likely they will change their favored coffee. However, it is quite easy in the coffee market to switch your brand when the price changes, especially in grocery stores. Also grocery retailers can switch their specialty coffee supplier for another, and although this is a little more difficult of a process, they have a substantial bargaining power. But because there are many specialty coffee consumers and not many well known specialty coffee producers, consumers do not have the same type of power they would have in other industries..

Entry and Exit

There is some prevention of new entrants into the specialty coffee market from having to develop their own product that rivals well known producers such as Peet's Coffee or Starbuck's. However, many times small coffee shops are able to establish a local fan base and do this by brewing their own coffee or that of other specialty coffee makers. Thus they are able to find a market share locally. Since input goods are basically the same for a well established coffee brand or newly starting stores and the industry lacks high technology, barriers to entry is limited. Also coffee stores do not require a large amount of floor space. So individuals look for an untapped space to start their own store. However, some of these "mom and pop" stores fail within the first three years like 2/3 of small businesses since they find they can't compete with the larger coffee retailers. The grocery coffee market is harder to enter since it requires more resources and more brand name accountability for consumers. Stores will only buy coffee if it has a reputation that they know there consumers will buy. Grocery sales also require some sort of grocery delivery and transportation service. Thus besides the local threat of entry from "mom and pop" stores, Peet's Coffee does not face any threat from entry and exit nationally.

Substitutes

In terms of beverages, there is a wide variety of substitutes for coffee including energy drinks, smoothies, tea, soda drinks, and orange juice. All of these are considered either breakfast or energy drinks and thus can replace coffee. However, the majority of coffee drinkers would not substitute away from coffee since they are a dedicated group of followers. The closest substitute would probably be tea, and Peet's offers this, even in their name, Peet's Coffee and Tea. The biggest substitute of retail coffee would probably be home production which is much cheaper, and even in this case, Peet's sells their coffee in a wide variety of grocery stores. In fact, their grocery sales are probably what they are most known for nationally and generate the most profit. So the company has done a good job of protecting itself from threats from substitutes by widening their channels of distribution

There is a variety of substitute products in the specialty coffee industry depending on the venue. In retail, larger coffee chains such as Starbucks, Caribou Coffee, compete with Peet's. In grocery sales, Peet's has less competition. There are low end brands of instant coffee such as Folgers or even the grocer's own brand. Since this is cheaper than specialty coffee it might begin to rival it especially with a weak economy. However, since these instant coffee products are no longer as popular in modern culture, they are becoming less of a substitute product. Also, if one considers the social aspect of drinking coffee, a substitute would also be alcoholic drinks.

However, generally the most threat is from other specialty coffee producers such as Starbucks. McDonalds and Dunkin Donuts also compete to some level, but have the negative connotation as cheap and not elite, so this probably doesn't appeal to Peet's customer base. These places can offer a warm breakfast, which Peet's Coffee cannot. Starbucks is beginning to infiltrate this market with beginning to sell their beans and instant coffee in grocery stores. However, now that Starbucks has become so ubiquitous it is beginning to loose its elite appeal and coffee producers such as Peet's. Thus coffee's main form of substitution comes in tea related beverages and home created coffee which are both offered in Peet's.

Complements

Complements in the specialty coffee industry include the sale of pastries and other breakfast foods. The attractiveness of these foods could help Peet's sales if people want to buy food with their coffee. Due to current health trends, breakfast is becoming a more popular and promoted meal so this could help Peet's. However, if Peet's breakfast pastries are classified as unhealthy, this could hurt Peet's sales.

Starbucks has tried to appeal to their consumers by including hot breakfast foods such as oatmeal and eggs into their menu. Starbucks has performed this addition to compete with bigger fast food chains such as McDonald's that offer these items together. However, Starbuck's addition has produced less than desired results, and these food items make up such a small portion of Peet's sales that they should not be pursued to a certain extent. Thus, complements to not hold as much of a threat to Peet's since most their consumers just care about the quality of coffee.

SWOT

Strengths

- A wide product line (coffee, beverages, tea and pastries)
- A reasonably well-known brand and image in California and the Pacific Northwest
- Success in differentiating its coffees
- Value of the Peet's experience
- The high levels of sales and equipment service support
- A good strategy that is being well-managed

- The company's strong emphasis on social responsibility (which enhances the appeal of its coffees to buyers with similar social consciousness)

Weaknesses

- A small, one-product company—which puts it at a serious disadvantage in bargaining with supermarket chains for favorable shelf space where there is no monetary switching costs for customers
- Brand name is relatively unknown compared to Starbucks and brands of major coffee marketers
- Much smaller financial and marketing resources than Starbucks and major coffee marketers

Opportunities

- Expansion into states where it has low market penetration (Mid-West and East Coast)
- Replace Starbucks as the premium specialty coffee provider
- Room to compete on multiple fronts such as quality and price

Threats

- A slowdown in the sales growth of premium coffees (consumer interest in specialty coffee begins to wane)
- Unfavorable economic conditions lower demand for expensive beverages
- The major coffee marketers make a big push to make their premium coffee brands dominant in the wholesale channel
- Higher prices for premium coffee bean
- Overall higher commodity costs

Financial Analysis

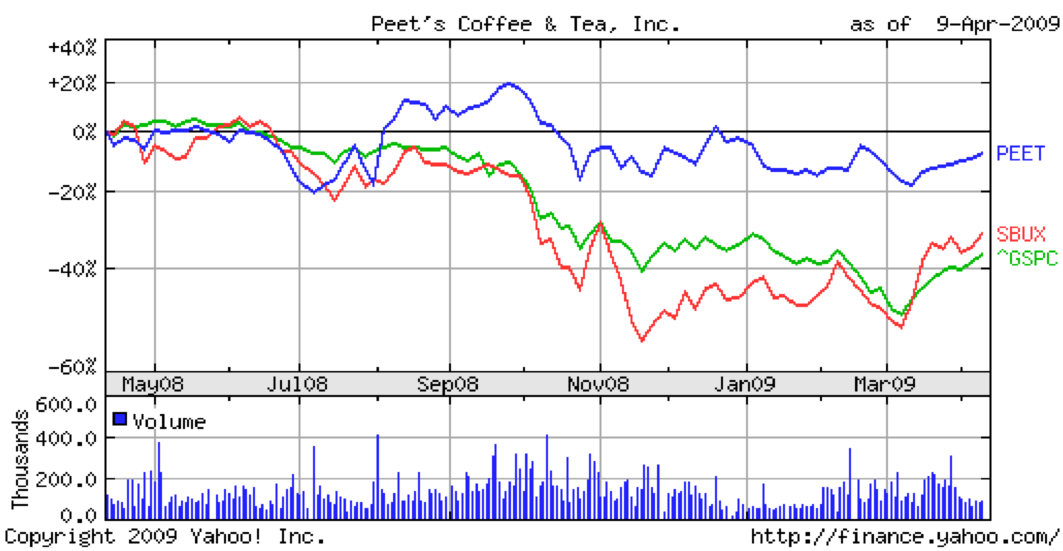
Overview

In fiscal year 2009 the company reported revenues of USD 249.39 million, an increase of 18.48% from the previous year. Operating profit was USD 11.61 million which increased 15.52% over 2006. In fiscal 2009 Peet's ROE was 7.67%, ROA was 6.23%, P/E ratio was 27.69, Earnings per Share was .8, and the operating profit margin was 6.19%.

A large financial concern for Peet's Coffee is whether the recent turmoil of the United States economy has made it difficult for consumers to justify paying $4 or more for a cup of coffee in the morning. Furthermore, increasing coffee bean prices inhibit the performance of the entire industry. A closer look at the financial statements of Peet's, and a comparison to one of its competitors, Starbucks will shed some light on these problems and help identify some of the strengths and weaknesses of the company. Peet's 2009 ROE of 7.76% is higher than Starbuck's 7.10%. This means that Peet's is slightly better at generating profits with the money invested by shareholders. Peet's also has a much higher operating profit margin of 6.19% compared to Starbuck's 5.24% and a higher quarterly revenue growth of 11.6% compared to Starbuck's decline of -5.5%. Although Starbuck's is a much larger company (last year's net income was 171.70M compared to Peet's 11.16M), Peet's Coffee seems to be doing much better at turning profits. Compared to another specialty coffee company, Green Mountain, Peet's performed worse in fiscal 2009. This is perhaps due to the fact that Green Mountain Coffee Roasters is strictly focused in the grocery business, which is currently the most successful, while Peet's Coffee attempts to manage many different channels of distribution.

	Market Cap	P/B	EPS	P/E	ROE	ROA	Operating Margin	Qtr Rev. Growth
Peet's	286.86M	1.98	0.8	27.69	7.67%	6.23%	6.19%	11.60%
Starbuck's	8.82B	3.28	0.23	51.72	7.10%	6.08%	5.24%	-5.50%
Green Mountain	1.31B	7.9	1.32	40.4	25.61%	8.22%	7.60%	55.80%

Peet's is also performing significantly better in the stock market. In the last 52 weeks PEET (Nasdaq) has ranged from $17.79 - 29.75, while Starbuck's has been trading from $7.06 - 18.56 in the last 52 weeks. Perhaps the largest financial problem to which Starbucks owes its declining stock price is the slowdown in its same store sales, which have experienced diminished growth for some time. It is quite possible that Starbuck's aggressive store expansion has led to cannibalization. Starbuck's company operated retail stores have nearly doubled since 2003. During such expansion, revenue growth rates can only be maintained if transactions are higher at the new locations than the amount that was lost from existing stores. In the past year, PEET has both over-performed SBUX and the S&P 500, as evidenced by the graph below. Despite rising coffee prices and economic downturn, Starbucks' problems are rooted in declining same-store sales, which may have other contributors such as cannibalization from aggressive store expansion. This is where Peet's might be able to come in and take the existing market share that Starbuck's has lost from their mistakes.



Profitability and Growth

In 2007 net revenue increased 18.5% from continued expansion of retail and specialty sales to $249.39 million. Operating profit of the company was $11.61 million during fiscal year 2007, representing a 15.5% over 2006. Peet's has two reportable segments: retail stores, which contributed to 67.5% of total revenues and specialty sales, which contributed 32.5% of total revenues in fiscal 2007. In 2007, sales of whole beans increased 14% to $134.1 million and sales from beverages and pastries increased 24.1% to $115.3 million. In the retail segment, net revenues increased 19.1% from 2006 as a result from increased sales from 30 new stores that opened in 2007. In retail, sales of whole bean coffee increased 8.1% while sales of beverages and pastries increased 24.9%. The slower growth of whole bean coffee is due to the cannibalization of whole bean sales in retail stores due to their increased availability in grocery stores.

In specialty sales segment, net revenue increased 17.2% from 2006. This $11.9 million increase consists of $7.4 million increase in grocery sales, a $1.2 million increase in home delivery sales, and a $3.2 million increase in foodservice and office sales. Grocery sales had the highest increase of 21.6% due to their addition of 1,400 new grocery stores in 2007. This brings the number of grocery stores that sell Peet's products to 5,800. Net revenue to the home delivery channel grew 7.0% compared to 2006 due to special offerings to existing customers. In addition, foodservice and office coffee revenue increased 18.7% due to efforts to expand distributorships and licensed partners.

Net Revenue of Specialty Sales				
(dollars in thousands)	**2007**	**2006**	**Increase**	**Percentage**
Grocery	$ 41,879	$ 34,440	$ 7,439	21.60%
Foodservice and office	20,430	17,211	3,219	18.70%
Home delivery	18,688	17,465	1,223	7.00%
Total specialty	$ 80,997	$ 69,116	$ 11,881	17.20%

Cost of sales and related occupancy expenses consisting of product costs, manufacturing costs, and rent increased from 47.0% in 2006 to 47.5% in 2007, as a percent of total net revenue. This increase was driven by an increase of occupancy as a percent of net revenue. Occupancy increased approximately 0.5% compared to 2006 due to the impact of opening new stores, which had lower sales level than previous stores. Operating expenses consist of both retail store and specialty operating costs, such as employee labor and benefits, repairs and maintenance, supplies, training, and travel. Operating expenses as a percent of net revenue for 2007 increased 0.1% to 34.4% from 2006. The increase was primarily due to a 1.2% increase from opening 55 new stores in the last two years. General and administrative expenses in 2007 were $22.7 million, or 9.1% of net revenue, compared to $20.6 million, or 9.8% for 2006. The decrease in expenses as a percent of net revenue is primarily due to higher net revenue.

In the fourth quarter of 2008, Peet's Coffee and Tea was had an EPS of $.29, better than the consensus of $.28. PEET was able to beat 4Q08 through belt tightening in the face of challenges. Peet's EPS for the year was .8. Overshadowing this success is believed to be the grocery channel in which PEET has placed its emphasis over the past two years. Revenues of $79.1 million was lower than expected from lower merchandise sales but it was also helped with a 20% growth in specialty sales in the grocery channel. PEET is slowing growth of its coffee shops to 10% from 17.5% and has instead turned to growing the higher margin specialty business. The first quarter of 2009 has an expected EPS of $.17-.19 and a 2009 EPS of $.94 to $1.00. Peet's EPS is expected to grow next year due to solid grocery channel growth as the company added almost 50% of stores in 2008 through east coast expansion. However, the challenges in the next quarter include a possible trade down to mainstream coffee due to the economic environment and Peet's recent strategy In 2009 Peet's has expected revenue of $318.6 million.

Liquidity

As of December 28, 2008, Peet's Coffee had $4.7 million in cash and cash equivalents and $8.6 million in short-term marketable securities for a total of $13.3 million. Working capital was $36.4 million as of December 28, 2008 compared to $38.4 million at December 30, 2007. Net cash provided by operations was $25.4 million in 2008 compared to $20.1 million in 2007. Operating cash flows were positively impacted in 2008 by net income.

Net cash used in investing activities was $19.0 million in 2008. During 2008, maturities net of purchases totaled $6.9 million as Peet's used funds to invest in property and equipment and the purchase of their common stock. Cash paid for property and equipment totaling $25.9 million included: $13.4 million to build new stores and remodel existing ones, $2.3 million used for foodservice kiosks and grocery displays, $1.9 million used for additional machinery for the new roasting facility, $3.9 million used for conversion of Peet's previous roasting facility into office space, and $4.4 million used for information technology support systems.

The 2009 capital expenditures are expected to be between $14.0 and $16.0 million. Approximately $8.5 million is expected to be used for the opening of about 10 new retail stores and for remodeling and to existing stores. Approximately $2.5 million is expected to be incurred for the design and development of a new enterprise resource planning system (ERP).

The following table summarizes the Company's contractual obligations and the timing of such commitments that are expected to have an effect on the Company's liquidity and capital requirements in future periods as of December 2008:

			Payments Due by Period (in thousands)		
Contractual obligations	**Total**	**Less than 1 year**	**1-3 years**	**4-5 years**	**After 5 years**
Equipment operating leases	$ 387	$ 295	$ 92	$ -	$ -
Retail store operating leases (1)	102,666	14,927	27,747	25,032	34,960
Fixed-price coffee purchase commitments	37,765	33,609	4,156	-	-
Not-yet-priced coffee commitments	384	305	79	-	-
Development commitments (2)	437	437	-	-	-
Total contractual cash obligations	$ 141,639	$ 49,573	$ 32,074	$ 25,032	$ 34,960

Strategic Recommendations

The strategic framework for Peet's coffee can be divided into three sections: competitive differentiation, distribution channels, and retail location. Peet's overall strategy can then be divided into short term which is dependent on the weakness of the current economy, and long term, in which expansion should be considered.

For their competitive strategy, Peet's biggest goal is to be able to differentiate themselves from their biggest competition in Starbucks. Starbucks has currently engaged in expansion in every aspect. They now have branched out into hot breakfast, a wide variety of individualistic drinks, and instant coffee now sold in grocery stores. By having retail stores in multiple locations, Starbucks is now becoming more of a fast food chain and considers its main competitor to be McDonald's At the same time, adding some variety to their drink menu could be helpful, as customers are used to the ability of Starbucks to make any drink they want, and this has been successful. However, adding too many drinks could be considered confusing to a loyal Peet's customer so this advice should be taken with discretion. Along with this, Peet's should try to advertise themselves as selling an experience. Starbucks caters to business people who want to get in and out with their daily coffee. If Peet's brings in the coffeehouse experience aspect, this would cater to a separate group of specialty coffee customers who want to enjoy their beverage and their buying process, and are even willing to pay more for the better customer service.

In terms of Peet's strategy for distribution channels, it seems as now they are focused in many different aspects of the specialty coffee business. Their channels include: retail, grocery, office and foodservice, and home delivery. I believe that Peet's needs to focus the company on those distribution channels that are the most profitable, which over the last few years have been retail and grocery. With so many channels, they cannot specialize in any area. I believe that Peet's needs to have a set goal for what kind of company they are looking to become. Also for brand recognition, it would be helpful to be associated with a main channel of distribution; just like Starbuck's is known for its retails stores or Folger's is known for their availability in grocery stores. Since Peet's foodservice/office and home delivery channels represent the smallest proportion of net sales and have experienced the least amount of growth, I think it would be profitable to either scale back on these operations or eventually cut them out of their business model entirely. The retail segment represents the largest proportion of sales but the grocery segment is the fastest growing so these two seem vital for the company's existence. However, because of the economic crisis, Peet's needs to analyze the current status of their retail and grocery store locations. If any of these appear to have declining growth in sales or are not operating at a profit, they should look into giving up their ownership. They should perform this analysis before they look into any future expansion. In the next year, Peet's does not seem to be opening too many stores and I believe this is a good idea. Retail stores are more of a risky business because they require such high fixed costs.

In terms of location expansion, this seems like a good long term goal for Peet's Coffee, but I don't think this is the year for company expansion especially retailas consumers are cutting back spending as a result of the economic recession. At the same time that Peet's competes with Starbucks for their market share, pursuing the same strategy of retail expansion could be considered dangerous. By having numerous stores, Starbucks has cannibalized their profitability of many of their existing stores. Peet's needs to differentiate themselves from Starbucks and so needs to avoid this strategy of excessive expansion and market domination. I believe that there exists an eventual market in the East Coast, and that a way to penetrate this market would be through the grocery stores instead of retail. Grocery stores require very little capital and investment but are able to reach a large amount of people. This way they could expose shoppers to their brand name without many costs. The east coast is somewhat loyal to Dunkin Donuts already as their grocery coffee brand, but I believe if it Peet's were to selectively choose which grocery stores in which their products were available they could be successful. I believe that stores which are already known as higher end such as Whole Foods would be successful because they are reaching out to a different kind of consumer, one that chooses quality of a product over price. If Peet's becomes successful in the specialty coffee grocery channel in the East Coast, then I believe they could look at adding retail stores as well there.

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Appendix

PEET'S COFFEE & TEA, INC.

CONSOLIDATED BALANCE SHEETS

(In thousands, except share amounts)

	December 28, 2008	December 30, 2007
ASSETS		
Current assets		
Cash and cash equivalents	$ 4,719	$ 15,312
Short-term marketable securities	8,600	7,932
Accounts receivable, net	11,924	8,287
Inventories	26,124	24,483
Deferred income taxes-current	2,922	2,950
Prepaid expenses and other	7,193	4,285
Total current assets	61,482	63,249
Long-term marketable securities	-	7,831
Property, plant and equipment, net	107,914	99,231
Deferred income taxes-non current	3,059	3,353
Other assets, net	3,897	3,883
Total assets	$ 176,352	$ 177,547
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable and other accrued liabilities	$ 9,858	$ 10,104
Accrued compensation and benefits	8,852	8,909
Deferred revenue	6,350	5,856
Total current liabilities	25,060	24,869
Deferred lease credits	6,645	4,924
Other long-term liabilities	740	501
Total liabilities	32,445	30,294
Shareholders' equity		
Common stock, no par value; authorized 50,000,000 shares; issued and outstanding:13,174,000 and 13,932,000 shares	90,123	104,616
Accumulated other comprehensive income	34	52
Retained earnings	53,750	42,585

Total shareholders' equity		143,907	147,253
Total liabilities and shareholders' equity	$	176,352	$ 177,547

PEET'S COFFEE & TEA, INC.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(In thousands)

	Common Stock Shares Outstanding	Amount	Retained Earnings	Accumulated Other Comprehensive Income/Loss	Total Shareholders' Equity	Comprehensive Income
Balance at January 1, 2006	13,902	$ 100,562	$ 26,392	$ (76)	$ 126,878	
Stock options exercised, including tax benefit	160	3,531			3,531	
Stock sold in Employee Stock Purchase Program	44	1,065			1,065	
Stock-based compensation		4,022			4,022	
Stock purchased in accordance with share purchase program	(590)	(15,934)			(15,934)	
Net unrealized gain on marketable securities, net of tax of $59				61	61	$ 61
Net income			7,816		7,816	7,816
Balance at December 31, 2006	13,516	$ 93,246	$ 34,208	$ (15)	$ 127,439	$ 7,877
Stock options exercised, including tax benefit	391	8,026			8,026	
Stock sold in Employee Stock Purchase Program	25	530			530	
Stock-based compensation		2,814			2,814	
Net unrealized gain on marketable securities, net of tax of $46				67	67	$ 67
Net income			8,377		8,377	8,377
Balance at December 30, 2007	13,932	$ 104,616	$ 42,585	$ 52	$ 147,253	$ 8,444
Stock options exercised, including tax benefit	133	2,484			2,484	
Stock sold in Employee						

Stock Purchase Program	50	939			939	
Stock-based compensation		2,711			2,711	
Stock purchased in accordance with share purchase program	(941)	(20,627)			(20,627)	
Net unrealized gain on marketable securities, net of tax of $12				(18)	(18)	$ (18)
Net income			11,165		11,165	11,165
Balance at December 28, 2008	13,174	$ 90,123	$ 53,750	$ 34	$ 143,907	$ 11,147

PEET'S COFFEE & TEA, INC.

CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share amounts)

	2008	2007	2006
Retail stores	$ 187,719	$ 168,392	$ 141,377
Specialty sales	97,103	80,997	69,116
Net revenue	284,822	249,389	210,493
Cost of sales and related occupancy expenses	133,537	118,389	98,928
Operating expenses	98,844	85,800	72,272
General and administrative expenses	22,519	22,682	20,634
Depreciation and amortization expenses	12,921	10,912	8,609
Total costs and expenses from operations	267,821	237,783	200,443
Income from operations	17,001	11,606	10,050
Interest income	726	1,446	2,456
Income before income taxes	17,727	13,052	12,506
Income tax provision	6,562	4,675	4,690
Net income	$ 11,165	$ 8,377	$ 7,816
Net income per share:			
Basic	$ 0.81	$ 0.61	$ 0.57
Diluted	$ 0.80	$ 0.59	$ 0.55
Shares used in calculation of net income per share:			
Basic	13,723	13,724	13,733
Diluted	13,997	14,120	14,202

PEET'S COFFEE & TEA, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	2008	2007	2006
Cash flows from operating activities:			
Net income	$ 11,165	$ 8,377	$ 7,816
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	15,113	12,861	10,244
Amortization of interest purchased	193	242	415
Stock-based compensation	2,711	2,814	4,022
Excess tax benefit from exercise of stock options	(462)	(1,350)	(724)
Tax benefit from exercise of stock options	285	1,234	708
Loss on disposition of assets and asset impairment	900	494	288
Deferred income taxes	322	(3,100)	(3,495)
Changes in other assets and liabilities:			
Accounts receivable, net	(3,637)	(1,449)	(1,686)
Inventories	(1,641)	(4,950)	(2,532)
Prepaid expenses and other current assets	(2,908)	(433)	(480)
Other assets, net	(21)	(45)	(244)
Accounts payable, accrued liabilities and deferred revenue	1,464	3,519	2,473
Deferred lease credits and other long-term liabilities	1,960	1,919	969
Net cash provided by operating activities	25,444	20,133	17,774
Cash flows from investing activities:			
Purchases of property, plant and equipment	(25,930)	(30,824)	(44,443)
Proceeds from sales of property, plant and equipment	67	23	28
Changes in restricted investments	(87)	-	1,500
Proceeds from sales and maturities of marketable securities	7,857	31,304	49,888
Purchases of marketable securities	(917)	(21,688)	(26,356)

Net cash used in investing activities	(19,010)	(21,185)	(19,383)
Cash flows from financing activities:			
Net proceeds from issuance of common stock	3,138	7,322	3,888
Purchase of common stock	(20,627)	-	(15,934)
Excess tax benefit from exercise of stock options	462	1,350	724
Net cash (used in)/provided by financing activities	(17,027)	8,672	(11,322)
(Decrease)/increase in cash and cash equivalents	(10,593)	7,620	(12,931)
Cash and cash equivalents, beginning of period	15,312	7,692	20,623
Cash and cash equivalents, end of period	$ 4,719	$ 15,312	$ 7,692
Non-cash investing activities:			
Capital expenditures incurred, but not yet paid	$ 734	$ 1,995	$ 2,751
Other cash flow information:			
Cash paid for income taxes	8,293	6,761	7,890