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# Starbucks Corp. (SBUX)

Goldman Sachs Global Retailing Conference

## CORPORATE PARTICIPANTS

Patrick J. Grismer  
*Chief Financial Officer & Executive Vice President, Starbucks Corp.*

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## OTHER PARTICIPANTS

Katherine Fogertey  
*Analyst, Goldman Sachs & Co. LLC*

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## MANAGEMENT DISCUSSION SECTION

Katherine Fogertey  
*Analyst, Goldman Sachs & Co. LLC*

Thank you for joining us here today. We're joined with Pat Grismer. He is the CFO of Starbucks. I'm Katherine Fogertey, the Restaurants Analyst. And we're very lucky to have Pat here today. So, he has a very rich history in restaurant and consumer broadly. He just joined Starbucks about a year ago as the CFO, but prior to that, he held a role as CFO of Hyatt, CFO of Yum! and also spent a good amount of time at Disney. So, good mix of consumer, restaurants and iconic brands for sure.

He will start off with a presentation and then, we're going to go to some prepared Q&A I have on my end. And then, we look forward to opening it up to questions from the group. So with that...

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Patrick J. Grismer  
*Chief Financial Officer & Executive Vice President, Starbucks Corp.*

Thank you, Katie, and good morning, everyone. I'm really privileged to be here with all of you today. There are a couple of key messages that I'd like to share ahead of our fireside chat if you will. The first is to highlight the strength of our results in fiscal 2019 and the second is to clarify the broad implications of our fiscal 2019 performance for our preliminary outlook for fiscal 2020.

First, I'd like to acknowledge our Safe Harbor statement here as I will be making some forward-looking statements.

So, starting with our performance in fiscal 2019, we are extremely pleased with our results this year with our non-GAAP EPS up about 16%, that's the midpoint of our current guidance range, and we believe that this performance reinforces the strength of our Growth at Scale agenda, which we are executing with focus and discipline. And as a reminder, that agenda has three key pillars. The first is to elevate our lead growth markets in the U.S. and China. The second is to extend the global reach of our brand, notably through our Global Coffee Alliance with Nestlé and the third is to increase shareholder returns.

So, as to that 16% non-GAAP EPS growth, that is well ahead of our original guidance, 9% growth at the midpoint and you can see here the key drivers of that outperformance, starting with better-than-expected performance of our core business through a combination of better-than-expected global comp sales growth as well as improved margin management that contributed 4 points of incremental EPS growth. That was slightly offset by 1 point of dilution from our Siren Retail business as well as 1 point of dilution from corporate G&A.

You can see as well that we faced an incremental point of headwind from foreign currency translation, but you can see that far and away the driver of our outperformance in fiscal 2019 relative to our original expectations was our effective tax rate. And that has significant implications for the shape of our growth in fiscal 2020, as that outperformance was largely driven by one-time discrete income tax benefits.

So, in terms of what those implications are, you can see here a chart that starts with our original guidance or outlook for both fiscal 2019 non-GAAP EPS growth as well as for fiscal 2020. And this is as we presented it at our Investor Day last December. And then you can see the next four lines, the individual items contributing to this year's outperformance and the corresponding implications for fiscal 2020.

So taking each one of these in turn, starting with our operating results, again, strong operating results this year, we expect that to sustain. Our operating growth model is intact, and we feel very good about the steps we are taking to drive both top line performance and bottom line performance. And I reaffirm what those components are, top line growth in the range of 7% to 9%, and operating income growth in the range of 8% to 10%.

As to the tax rate, again given the one-time nature of the benefits that we realized in fiscal 2019, you can see that it's a very significant headwind to our EPS growth in fiscal 2020 as we lap those benefits.

And then with respect to share repurchases, we elected to pull forward about \$2 billion worth of share repurchases that we had originally planned for fiscal 2020 into fiscal 2019. And the context for that is that in the last year, our share price has increased by more than 80%.

So in the context of a rapidly appreciating share price and given that we have the liquidity to do it, we pulled forward those share repurchases and we're able to preserve what we had expected by way of an EPS growth contribution from share repurchases net of the associated interest expense. And with that pull forward then, there will be lower aggregate share repurchases in fiscal 2020 and the associated EPS benefit net of interest expense on the debt issuances this year as well as what we expect to issue next year will be tempered relative to our original expectations.

So you add all of that up and what that means is that for fiscal 2020, our EPS outlook is below our ongoing growth model of at least 10%. But again, I want to reinforce that our Growth at Scale agenda is delivering against our expectations. I would say that we're firing on all cylinders from an operating performance perspective with the focus and discipline necessary to drive Growth at Scale for a company like Starbucks, and our long-term double-digit EPS growth model is fully intact. But again, we do expect an EPS growth outlook for fiscal 2020 that is meaningfully below the ongoing algorithm that we had laid out at our Investor Day.

And so with that, I'd like to turn it over to Katie to lead us through a fireside chat and then, as Katie mentioned, I'm happy to take questions from the audience. Thank you very much.

## QUESTION AND ANSWER SECTION

Katherine Fogertey

*Analyst, Goldman Sachs & Co. LLC*

Q

Great, thank you. So Starbucks is one of those amazing large companies that has such strong ties to the macro. You are benefiting from record low unemployment rate, very strong wage growth. I'm just curious. What are you seeing right now from the consumer boots on the street? How is the consumer behaving right now?

Patrick J. Grismer

*Chief Financial Officer & Executive Vice President, Starbucks Corp.*

A

We see in the U.S. a very healthy consumer. As I mentioned before, we're very pleased with our operating performance in fiscal 2019. We recently raised our guidance for comp sales growth, given the strength of performance in the first three quarters. We track very carefully the APT Restaurant Index to understand what's happening in the industry from a sales and transaction perspective.

And I'm thrilled to share that in the last four quarters, Starbucks has outperformed that index from a sales perspective; in the last three quarters outperformed from a transaction perspective. So we are seeing a healthy consumer in the U.S., but also we are seeing outperformance for Starbucks on the strength of what we are doing to drive and improve customer experience to lead with breakthrough beverage innovation and then to supplement with compelling digital initiatives.

Katherine Fogertey

*Analyst, Goldman Sachs & Co. LLC*

Q

That's great. That actually tees up to my next question. You guys had a very strong cold platform a couple years ago, and that struggled as consumer preferences changed. You spent a lot of time developing a new cold platform. We have Nitro now in almost all the stores. I'm curious the strength, especially with that 7% comp that you reported last quarter. How much of what we're seeing right now is early success on cold that is repeatable going forward versus strong macro? How would you distinguish the two?

Patrick J. Grismer

*Chief Financial Officer & Executive Vice President, Starbucks Corp.*

A

A strong macro certainly is contributing to our performance this year. But as I mentioned, there are things that are unique to Starbucks that are driving our outperformance versus the industry generally. And I mentioned breakthrough beverage innovations, one of those and I would highlight within that the unique strength of our cold beverage platform.

As you mentioned, in recent years we had seen a decline in our cold beverage platform, largely because of the declining consumer interest in our Frappuccino line, seen as a very indulgent beverage. And to your point, as consumer preferences changed, we saw the opportunity to pivot to something new, something different, something that was more relevant, and that spoke to consumers' desire for a lighter offering.

And so Cold Brew and more recently Nitro Cold Brew along with our Refreshers line of flavored teas have done extremely well, not only to help replace the Frappuccino business that we had lost, but importantly to drive improved traffic in the afternoon, which is where we had seen pressure in recent years.

I would say what is different about this platform compared to the past is that it is resonating with consumers in terms of the type of beverage they're looking for, something that has a very distinctive taste profile, but also is a lighter beverage, which satisfies what they're looking for from a wellness perspective. And then, the other thing is that, particularly with the advent of Nitro Cold Brew, which is a highly proprietary platform, we are now in a strong position to innovate around that platform to bring new taste, excitement and point of differentiation for our customers.

Katherine Fogertey

*Analyst, Goldman Sachs & Co. LLC*

Q

We just saw the Pumpkin Cold Brew with the Nitro. What is the exact terminology of that?

Patrick J. Grismer

*Chief Financial Officer & Executive Vice President, Starbucks Corp.*

A

The Pumpkin Cream Cold Brew.

Katherine Fogertey

*Analyst, Goldman Sachs & Co. LLC*

Q

So that to me seems like it would be a sign of innovation around that platform. It's still early in the launch, but I'm curious if that reception has been any different.

Patrick J. Grismer

*Chief Financial Officer & Executive Vice President, Starbucks Corp.*

A

We're very pleased with how our Cold Brew and Nitro Cold Brew platforms have been embraced by consumers generally. You'll have to wait for our Q4 earnings release to find out precisely how much consumers have rallied around it, but no doubt you've seen the significant social media and traditional media attention to, what I like to call, PCCB, Pumpkin Cream Cold Brew. And I encourage all of you who've not tried it to go out and give it a try. It's really a sensational beverage.

Katherine Fogertey

*Analyst, Goldman Sachs & Co. LLC*

Q

And then, how should we think about – you had talked about a 1% comp lift on stores that had Nitro. As consumer awareness grows, how is that evolving?

Patrick J. Grismer

*Chief Financial Officer & Executive Vice President, Starbucks Corp.*

A

The 1% you referred to is what we observed a couple of years back when we are first testing Nitro Cold Brew. It was part of a test market and that's what gave us confidence to proceed with the nationwide rollout. So, as of the end of Q3, we were in 5,800 company-owned stores here in the U.S., on track to achieve 100% penetration by the end of this fiscal year, which is end of September for us.

However, in having crossed the 80% penetration boundary at the beginning of August, we went on air with Nitro Cold Brew for the very first time. So, even as we were seeing Nitro contribute to our overall comp performance on the strength of our cold platform generally, bear in mind that through the third quarter, that was without the aid of advertising. So, we started the advertising beginning of August, again that was in the second month of our fourth fiscal quarter and we're certainly seeing good response to that.

Katherine Fogertey

*Analyst, Goldman Sachs & Co. LLC*

Q

And it's great. One of the things about Starbucks that maybe not everybody fully appreciates is that it is a business that runs on loyalty. So, you talked about over 40% of the sales in your stores, your company-owned stores, are coming from My Starbucks Rewards members. You do have a very strong My Starbucks Rewards platform, but you have a much stronger digital relationship moat out there. And so, I'm curious how is Starbucks going to continue to grow the My Starbucks Rewards and what does that trajectory look like?

Patrick J. Grismer

*Chief Financial Officer & Executive Vice President, Starbucks Corp.*

A

So, there're several angles to how we look to further leverage the strength that we have in loyalty and overall digital engagement. As you know, earlier this year, we re-launched our Starbucks Rewards program here in the U.S. with new tiers for redemption. And we've seen, as we talked about on our Q3 earnings call, tremendous customer acceptance of this new structure.

So, by continuing to innovate around the structure of the program, it creates increased appeal for those who aren't members of the program, who see the opportunity to earn and redeem more flexibly than before. So, that's one way that is to continue to innovate around that program. The other to your point, Katie, is how we engage those customers who are not members, but are nonetheless digitally engaged, because they give us their e-mail address when they sign up to use Wi-Fi in our stores. That provides us an avenue to communicate with them to tell them about the benefits of membership, to offer them promotions that will encourage them to come more frequently and hopefully through that experience also to understand the benefits of being a member.

The last one I would highlight is Mobile Order and Pay. And so, about a year ago, we opened up Mobile Order and Pay to customers outside of the Starbucks Rewards program and what we have seen is that, as customers have the opportunity to engage with us digitally for that type of experience, they come to appreciate the additional benefits that come with being a member and having all of the functions and features that you have through our app.

So, multiple ways of communicating with and engaging those digitally-registered customers in ways that motivate them to become full-fledged members of Starbucks Rewards. And we continue to see that, as customers make that choice to become members, their spend increases, because it allows us to understand better their unique preferences, their buying patterns and, therefore, to target our offers to what will resonate most with them.

Katherine Fogertey

*Analyst, Goldman Sachs & Co. LLC*

Q

And so, when we think about converting the digital customer to the MSR, clearly there's a number of benefits to bringing people onto the overall digital ecosystem and the platform. What is the conversion rate and you don't have to give a specific number now, but do you see a large runaway to improve that? Are we running at a pretty stable rate for converting digital to MSR? How should we think about that?

Patrick J. Grismer

*Chief Financial Officer & Executive Vice President, Starbucks Corp.*

A

Conversion has been fairly steady.

Katherine Fogertey  
*Analyst, Goldman Sachs & Co. LLC*

Q

Okay.

Patrick J. Grismer  
*Chief Financial Officer & Executive Vice President, Starbucks Corp.*

A

I would say, given the sheer magnitude of the digitally-registered population, there is significant potential for us to continue to drive growth in membership, and we've seen nice growth in membership. Here in the U.S. versus prior year, we're up in the low to mid-teens, that's annually. So we're seeing steady growth there, but as I mentioned before, relative to the size of the digitally registered population, much more opportunity for us to continue to drive membership.

Katherine Fogertey  
*Analyst, Goldman Sachs & Co. LLC*

Q

Great. So now for this part of Q&A, you have two very big markets. One is a lot bigger than the other, but you have China and the U.S. And so, I thought it would be pretty interesting to sit here and compare and contrast several very important initiatives that you have going on across these two spaces. So you touched on the U.S. consumer being very strong. Anything in China that we should be aware of when thinking about that market?

Patrick J. Grismer  
*Chief Financial Officer & Executive Vice President, Starbucks Corp.*

A

We are very pleased with the overall performance of our business in China. We have seen comp sales in the last year taper, and that is consistent with what we're observing in the market generally, which is that while the economy continues to grow at a relatively strong pace, it is less strong than it was two and three years ago, and certainly we're seeing that show up in retail footfall.

We're also seeing a much higher level of competition. I would say, to a great extent, Starbucks has demonstrated in China the appeal of the premium coffee specialty retail category. And that has attracted a lot of competition not just in coffee, but also in teas. So with that, there's more competition.

The final thing I would say that is weighing on the comp sales performance we're seeing in China is our own development. So as you know, for many years we have realized extraordinary returns in our new unit investments in China, on the order of 80% cash-on-cash returns, so really quite extraordinary. And given the scale of the market and our strong premium positioning, we believe that we are very well positioned to capitalize on those trends and continue to grow at a very aggressive pace, but that does come to some extent at the expense of comp sales growth. So really a combination of those three, the economy being one of those.

Katherine Fogertey  
*Analyst, Goldman Sachs & Co. LLC*

Q

And are you seeing – and you hinted at cannibalizing your stores a little bit in new markets in China. Are you seeing that more of a problem for a Tier 1 city versus Tier 2 and Tier 3? How should we think about that?

Patrick J. Grismer  
*Chief Financial Officer & Executive Vice President, Starbucks Corp.*

A

Definitely a much stronger headwind in the Tier 1 cities where we are more heavily penetrated, where when we go in with new development, we are more apt to impact one of our existing units. But we do that knowingly, we do

that intentionally, because we're solving for the long-term opportunity. And I would highlight that in recent years, we've continued to grow our total transactions in China in the double digits and we're growing stores in the mid-teens. So we're playing the long game in China.

Katherine Fogertey

*Analyst, Goldman Sachs & Co. LLC*

Q

Sorry. And just again, comparing the tracked model here, looking at the U.S. where you guys have just a phenomenal footprint here, are you seeing similar levels of cannibalization when you put in new stores here as you are there? Is there any kind of parallel to draw?

Patrick J. Grismer

*Chief Financial Officer & Executive Vice President, Starbucks Corp.*

A

Less cannibalization here, in part because we're growing at a slower pace, whereas China new units or net units are growing in the mid-teens. Our outlook for the U.S. is in the range of 3% to 4%, which I think is still very strong for a concept of Starbucks scale in the U.S. And what underpins that 3% to 4% growth rate is that there are still regions in the U.S. where Starbucks is under-represented largely in the center of the country and in the Southeast, some parts of the Northern Plains. There's a lot of white space out there for us, and we're continuing to open in particular drive-thru units, which offer even better economics because they come with higher average unit volumes and a superior margin profile.

Katherine Fogertey

*Analyst, Goldman Sachs & Co. LLC*

Q

Perfect. Now on drive-thru, delivery, there's great stuff that you go outside of the equation, you have a partnership with Alibaba in China. You have announced an exclusive with Uber Eats in the U.S. And I'm just curious, the Chinese delivery market much more evolved and further along than in the U.S. You have been trialing delivery for a while. Our survey all suggests that coffee is strangely a very requested item for delivery. So that piques my interest. What are you seeing here across both markets on delivery?

Patrick J. Grismer

*Chief Financial Officer & Executive Vice President, Starbucks Corp.*

A

I'll start with China. To your point, the Chinese consumer is much more digitally engaged, so we see higher levels of pickup and delivery overall for China. And just to maybe level-set, both the U.S. and China for Starbucks are in their first year of delivery operations, so it's early days for us. And so we are rapidly learning and adapting the model as we go, but in China, we've seen much more rapid adoption of the delivery occasion.

You mentioned our partnership with Alibaba. We could not be happier with that relationship and how they've supported us and our growth of the digital business, leading with delivery and now more recently with Mobile Order and Pay. So, another angle of our digital growth agenda in China and we're seeing very rapid adoption.

Contrast that with the U.S. where we've had Mobile Order and Pay for many years and that has proven to be quite successful for us, in fact I would say and perhaps many of you have experienced this during the peak morning hour in particular, Mobile Order and Pay has led to capacity constraints. I suppose it's a high-quality problem to have in retail where there is latent demand and the opportunity for us is to unlock the capacity so that we can accommodate all of that demand. But interestingly, in the U.S., as strong as Mobile Order and Pay has been, the pickup, the customer pickup on delivery has been much more tempered.

So we are now in a handful of markets in the U.S. expect, through our partnership with Uber Eats, to reach national coverage by the early part of 2020, but I would say that our expectations are that the business would grow over time. We know that convenience is an important need-state for customers generally and we've found that for Starbucks specifically that convenience is very highly valued.

So we believe that, over time, a delivered beverage will be a more commonplace, if you will, in the U.S. and that we would see higher levels of acceptance, but I would say that it's building relatively slowly here in the U.S.

Katherine Fogertey

*Analyst, Goldman Sachs & Co. LLC*

Q

And what you are seeing on the delivery side, would you say you're having more success on food delivery, are consumers looking for food delivery over a beverage or it's just very early days?

Patrick J. Grismer

*Chief Financial Officer & Executive Vice President, Starbucks Corp.*

A

For Starbucks, it is a delivered beverage with the attachment of food. And what we are seeing in the U.S., one of the things we've observed across all of our markets where we've led with delivery is a higher ticket compared to an in-store purchase and a contributing factor to that is a higher rate of food attached. And I think it makes sense if you're ordering a beverage for delivery, you might as well have some food delivered along with it. I would say the other contributing factor, and you see this particularly in office environments, is that the average party size is higher. And again that makes sense if someone in the office is ordering out for Starbucks, chances are colleagues will hop onto that same order.

Katherine Fogertey

*Analyst, Goldman Sachs & Co. LLC*

Q

And are you seeing anything different with daypart or day of week with the delivery business than you are within store?

Patrick J. Grismer

*Chief Financial Officer & Executive Vice President, Starbucks Corp.*

A

It varies from market to market. So, the very first market that we moved into with delivery, in fact it was our pilot market with Uber Eats, about a year ago was in Miami and we did see stronger sales in the afternoon daypart in that particular market. We're seeing that in some other markets as well, which helps to complement, which what has been, as you know, traditionally a very heavy breakfast or morning daypart.

Katherine Fogertey

*Analyst, Goldman Sachs & Co. LLC*

Q

That's really interesting. And touching back on what you were talking about with Mobile Order and Pay and Alibaba in China, is this helping to move the needle? Do you see this as an opportunity to help drive more of a morning daypart in China? How are customers using Mobile Order and Pay there?

Patrick J. Grismer

*Chief Financial Officer & Executive Vice President, Starbucks Corp.*

A

We do see that, over time, it will be helpful to us in terms of how we can better distribute our sales across the day. What you've highlighted is that in China as opposed to the U.S., we have a stronger afternoon daypart and so we do have more capacity in the morning. I do think that Mobile Order and Pay helps to facilitate and establish

routine. So, I think that has more Chinese consumers move into coffee and they understand the important role that coffee can play in one's morning routine if that will help to facilitate the growth of that daypart.

Katherine Fogertey

*Analyst, Goldman Sachs & Co. LLC*

Q

Yes. I very much understand the importance of coffee in the morning routine. And so, you referenced this a little bit with the rise of Mobile Order and Pay in the U.S., but I think it's actually a very good point. We go into some of these stores, especially the stores in heavy transit areas in New York, where Mobile Order and Pay is just swamping the stores. You walk in and there's just cups everywhere and a lot of crowds and it's certainly a high-class problem to have, but how are you guys thinking about the evolution of this business? And does it make sense to have a third space for Mobile Order and Pay or should they exist in two separate locations?

Patrick J. Grismer

*Chief Financial Officer & Executive Vice President, Starbucks Corp.*

A

So, we are in the process of rolling out improvements to what we call the hand-off plane, which is where you see those mobile orders accumulating in order to facilitate that part of the customer experience. You may have observed, particularly in stores in major metro areas like Manhattan, we are deploying additional labor in front of the counter to help direct traffic, if you will, to guide Mobile Order and Pay customers to where those orders are accumulating and to hand off those orders to customers as they come in.

At the same time, we are looking, over the next year, to improve, what we call, order sequencing, so that we can better stage or sequence orders that are taken inside the store as well as those that are coming in digitally in order to prepare the beverages in a sequence that better matches the arrival sequence of customers.

So a number of things we're looking to do to improve the experience for our partners as well as for our customers and with that to unlock some of those capacity constraints, so that we can accommodate more of the latent demand that time of day.

Katherine Fogertey

*Analyst, Goldman Sachs & Co. LLC*

Q

On that point of sequencing, is it taking into account the customers' location where they have placed the Mobile Order and Pay?

Patrick J. Grismer

*Chief Financial Officer & Executive Vice President, Starbucks Corp.*

A

That's exactly right.

Katherine Fogertey

*Analyst, Goldman Sachs & Co. LLC*

Q

Okay. I can start opening it up to Q&A. I have more questions, but does anybody in the group have a question?

Okay. On the labor front, labor wage inflation has been such a huge pressure to all the restaurant companies right now and you definitely pay kind of, I would say, above minimum wage to your partners and provide them with a lot of really good benefits. But you have also been doing a lot on the operations front to help kind of streamline that process in the store. So, I was wondering if you could help us understand what are the things you're doing, how is this translating on the labor line and also to guest satisfaction.

Patrick J. Grismer

*Chief Financial Officer & Executive Vice President, Starbucks Corp.*

A

So, what we're looking to do is to reduce non-customer-facing tasks through technology and improve processes, so that we can devote more partner time to the customer-facing experience if you will. So, it's not about necessarily driving efficiencies that drop through to the bottom line, but allowing us to reallocate our hours in ways that help to sustain robust top line growth.

That would include what we're doing to re-engineer our cleaning processes, what we're doing to re-engineer our inventory management processes and also enhance our labor scheduling both the speed and efficiency with which those schedules are set, but also to more intelligently allocate those hours and schedule those hours to the times of the day and to the tasks that are going to have the greatest impact on the partner customer experience. So, for us, it's about finding those efficiencies that allow us to make the important investments in partnered labor that are fundamental to Starbucks. We think that it's an important competitive advantage for us and it's something that we're going to continue to invest in.

Katherine Fogerty

*Analyst, Goldman Sachs & Co. LLC*

Q

And how have – the better customer scores, how has that translated into sales growth for you guys?

Patrick J. Grismer

*Chief Financial Officer & Executive Vice President, Starbucks Corp.*

A

We do see a strong correlation between our customer connection scores and comp sales by the store. So, we are very much of the belief that driving an improved customer experience, which starts with providing an extraordinary partner experience, is essential to our ability to drive comp sales on an ongoing growth – on an ongoing basis here in the U.S. in the range of 3% to 4%, which is part of our long-term growth model.

Katherine Fogerty

*Analyst, Goldman Sachs & Co. LLC*

Q

Okay. Yes, in the back?

Q

Just to piggyback off that question a little bit, on the wage and labor front obviously, there's a lot of concern out there about domestic recessionary pressures and the like, but doesn't appear to be showing up in consumer-focused data. But with respect to the labor and wage situation, are you feeling any pressure right now in terms of competition from competitors in the sense that are luring away your employees at a higher wage? Do you feel pressure to pay more or you're seeing that seemed to taper off a little bit corroborating some of the worries that are out there?

Patrick J. Grismer

*Chief Financial Officer & Executive Vice President, Starbucks Corp.*

A

The current situation is largely unchanged from what we've experienced in recent years, which is that, to the point Katie made, given what our pay practices have been historically, we have had a bit of a leg-up on the competition, but beyond the wage rate is the compelling benefits package that we offer, which is really, I think, unmatched in the retail space. And that's an important asset for us as it relates to our ability to attract and retain really strong retail talent.

Katherine Fogertey  
*Analyst, Goldman Sachs & Co. LLC*

Q

Yes?

Q

A three-part question. Can you first talk about food, that you've made some acquisitions over the years, but I think your progress in food has been somewhat underwhelming?

Second question is alcohol, you've made some initiatives in alcohol in sales, I'm wondering where your thoughts are on that. And thirdly, Luckin Coffee and if you could comment on them.

Patrick J. Grismer  
*Chief Financial Officer & Executive Vice President, Starbucks Corp.*

A

Certainly. So, starting with food, you're right to notice that, as we talk about the key drivers of our growth going forward, food does not figure prominently in that strategy, and that's not to say that food is not important to our business. Current sales mix is I think around 21%, so it's a decent part of our business. But as I mentioned before, our Growth at Scale agenda has been, to a significant extent, rooted in focus and discipline.

And when you think about a company of scale like Starbucks, given our stature as a brand and our scale globally, to sustain double-digit EPS growth over the long term requires considerable focus and discipline. One element of focus is being very clear about what our points of differentiation are and putting our effort, energy, and resources behind those key points of differentiation. For us in relation to product offerings, that's about beverages. So the innovation focus for us in terms of what's going to drive the top line is around beverages.

Food, I would say, is somewhat secondary in the sense that we see food as a complement to beverages. It helps to build ticket, it helps to build out additional dayparts, but it is not necessarily a key point of differentiation for us. Our goal is to make sure that it is of consistently high quality, consistent with the Starbucks brand, and that our food products pair well with our innovative beverage offerings. So that's food.

With respect to alcohol, I think what you have seen have been isolated examples. We don't see alcohol as figuring prominently into our growth strategy going forward. There may be unique occasions or instances, for example, in our Roasteries or maybe from time to time in some of our Reserve stores, but it will not figure prominently in our growth strategy going forward.

And finally in relation to Luckin, it's been interesting to see the growth and the evolution of that concept here in the last couple of years. I have to say that their unit growth is impressive. They, I think for the first time as a publicly held company reported results in the month of August. And with those results, what we saw was that their unit count in China is about 25% lower than Starbucks at that point in time. And their average unit volume is about 75% lower or one-fourth Starbucks average unit volume. So you add those two things together and even with all their growth, they're 80% smaller than Starbucks, one-fifth the size of Starbucks in China, but they have grown very rapidly.

I think it's important to highlight that they're going after a different occasion. Their occasion is not a third place occasion. They don't have cafés designed the way ours are. That I think is reflected in their very low average unit volume and they satisfy, again, a different occasion at a different price point, which also implies a different quality offering. So they're going after a different segment in the market.

It's not to say that we should dismiss the presence that they've established, but also bear in mind that they have done that on the back of extreme marketing and very aggressive discounts. And I think it remains to be seen how they will be able to sustain that growth, as over time they will be compelled to strip away their marketing and their aggressive discounts. So we're continuing to watch to see what they do. I mentioned earlier that one of the three contributing factors to the tapering of comp growth in China for Starbucks has been competition generally. I would say not necessarily Luckin specifically, but they've been part of that mix.

Katherine Fogertey

*Analyst, Goldman Sachs & Co. LLC*

Q

Okay. You referenced earlier you guys pulled forward \$2 billion of buyback into this year with more of a strategic decision. I'm just curious, you have so much dry powder on your balance sheet. You probably could raise more capital if you wanted to from the credit markets. Why was it the pull forward and why not accelerate share returns here, or do you need to have more cash on the balance sheet for other items?

Patrick J. Grismer

*Chief Financial Officer & Executive Vice President, Starbucks Corp.*

A

We don't need to have more cash on the balance sheet for other items, as the company undertook a review of its capital structure about a year ago. The decision was made to pivot to a more highly leveraged model, but still well below our peer companies in the category. So settling in at still investment-grade credit at a leverage ratio on lease-adjusted EBITDAR of no more than 3 times and a credit rating of BBB+, Baa1, which I think, for Starbucks, is a terrific place to be in terms of how it improves our overall cost of capital, but still gives us the flexibility to make the kinds of investments that we believe are instrumental to our ability to sustain long-term growth.

Katherine Fogertey

*Analyst, Goldman Sachs & Co. LLC*

Q

And then on the CapEx front, you've had a pretty healthy CapEx budget as you're building out stores in the U.S. and in China and you referenced earlier the scale of U.S. adds is slowing here. Is the current run rate a good run rate for CapEx? Is there something that would cause it to remain higher than unit growth over time? How should we think about CapEx?

Patrick J. Grismer

*Chief Financial Officer & Executive Vice President, Starbucks Corp.*

A

I would first clarify that when we say runway – run rate, not speaking to save the last three to five years when CapEx increased very dramatically, but really looking at what our current spend rate is, this year, I see the opportunity for that to temper when you take into account a couple of things. The first is that, as we bring increasing focus to our two lead growth markets, the U.S. and China, that implies that, over time, we will be transitioning other company-owned markets to the licensed model as we did this past year with France, Netherlands and, most recently, Thailand. And there're some other company-owned positions that would make sense at the right time under the right circumstances to transition to a licensed model.

And so, that will provide some relief to our total capital spend, that in addition to Siren Retail, which, as our CEO, Kevin Johnson, highlighted a little over a year ago at the Oppenheimer Conference, has been ring-fenced with the opening of our Chicago Roastery later this year, which we're very excited about, that will signal the end of Roastery development. And there's been quite significant capital investment against our Roastery portfolio in the last three years or so. And so, as we bring that program to completion, then we would again expect a more tempered level of capital spend.

Katherine Fogertey

*Analyst, Goldman Sachs & Co. LLC*

Q

Great. On the Channel Development side, you guys are adding more countries here. Can you help us understand how this business evolves and how the cost structure and the revenue opportunity is as you add more countries?

Patrick J. Grismer

*Chief Financial Officer & Executive Vice President, Starbucks Corp.*

A

So, with the Global Coffee Alliance with Nestlé, we are excited about how that is going to further unlock the opportunity for us to drive the presence of the Starbucks brand and consumer products goods channels, not only traditional grocery retail, but also in food service.

And to date, we are in 16 countries and we expect that with the relationship with Nestlé that we will be able to penetrate very rapidly the remaining 60 to 65 markets where we have a retail presence. One of the things we've observed is that it makes sense to lead with specialty retail to establish the brand that creates awareness, that creates brand preference and then to follow with consumer packaged goods. And Nestlé has the global infrastructure in consumer packaged goods to accomplish that at an accelerated pace, certainly much faster than we could have on our own, which was the underlying driver of that relationship that was established a little over a year ago.

How that relates to our revenue growth is that we do earn a royalty on those sales and we also receive a markup on some of the finished products that we continue to manufacture for Nestlé to distribute. So, there is an ongoing revenue stream in the form of royalties and product markups that follows the market expansion plan that I mentioned.

With respect to the overall profitability, we continue to expect for our Channel Development segment operating margin in the mid-30% range. So, decent margins on that business.

Katherine Fogertey

*Analyst, Goldman Sachs & Co. LLC*

Q

And then, I have one last question for you, you have 30 seconds left. So, one year and almost at Starbucks, what do you think is the greatest challenge here for Starbucks as we look ahead?

Patrick J. Grismer

*Chief Financial Officer & Executive Vice President, Starbucks Corp.*

A

The greatest challenge for Starbucks is how to continue to reduce the operational complexity of our retail stores. When you think about the volumes that we processed through our stores, transaction volumes, they are quite extraordinary, particularly at peak. And when you consider how we're continuing to introduce new beverage innovation, that adds another layer of operational complexity.

As I mentioned before however, what's fundamental to our success as a brand what we see as our number one competitive advantage is the unique experience we provide in our stores and at the center of that, the connection that exists between our partners and our customers. So, finding ways to continue to drive volume and drive innovation while reducing operational complexity that helps to unlock capacity and facilitates even deeper connections between our partners and our customers that I would say is the key.

And a corollary to that, from a financial perspective, is how we pace and sequence the investments necessary to enable that reduction in operational complexity even as we innovate, because we believe that continuing to invest

behind growth is important. It does weigh on our operating margin, but we believe that it's essential to our ability to drive top line growth consistently over the long term. And as I mentioned before, at the outset of the presentation, we continue to be very confident and the robustness of our double-digit EPS growth model at scale.

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## Katherine Fogertey

*Analyst, Goldman Sachs & Co. LLC*

That's great. Thank you, all, for your time today.

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## Patrick J. Grismer

*Chief Financial Officer & Executive Vice President, Starbucks Corp.*

Thank you very much.

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