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MANAGEMENT DISCUSSION SECTION

Chris O'Cull
Analyst, Stifel, Nicolaus & Co., Inc.

Thanks, everyone, for joining us this morning. My name is Chris O'Cull. I'm the restaurant analyst at Stifel and on behalf of all my colleagues, welcome to our Cross-Sector Investor Conference. I want to offer a special thanks to my guest, Pat Grismer, who is the CFO of Starbucks.

Pat, we really appreciate your willingness to share your time and thoughts with us today and I'm certainly looking forward to discussing the business with you. Pat is going to make a few opening remarks. And then, we'll have a more informal conversation following his comments.

So, with that, welcome, Pat, and thank you for participating.

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

Thank you, Chris, and hello, everyone. There are three thoughts that I'd like to share ahead of our chat with reference to some slides that we're posting to our IR website, highlighting key points that are further detailed in the 8-K that we filed this morning to maintain transparency with all Starbucks stakeholders regarding the journey we're on as we respond to the impact of the COVID-19 pandemic and further position the company for long-term growth.

Three points to highlight. Number one, Starbucks' sales and profits are recovering nicely. The worst is clearly behind us. Number two, Starbucks' liquidity position remains strong, bridging us to free cash flow positive as we exit our fiscal third quarter. And number three, Starbucks is capitalizing on an opportunity to accelerate the strategic repositioning of our US urban store base for future growth, supporting our double-digit EPS growth model for the long term.

So, I'd like to make just a couple of comments about each one of these three points. So, starting with sales and profit recovery, as we have reopened our stores, we've seen solid sequential improvement in sales, led by our two lead growth markets, China and the US. Bearing in mind that China is about two months ahead of the US on the

COVID-19 journey, China exited the month of May with weekly comps down 14%, well up from the weekly low of about minus 90% in mid-February. This is much better than we had expected. So we've raised our outlook for China's Q3 comp accordingly, compared to the guidance provided with our Q2 earnings report in early May.

The US exited the month of May with weekly comps down 32%, nicely up from the weekly low of about minus 65% in mid-April and trending ahead of prior expectations. And as sales are improving, so is our margin performance, as we have better visibility to sales and are better-positioned to manage store-level profitability.

So the second point, as to our solid liquidity position. We issued $3 billion of bonds in May at very attractive rates, covering our fiscal third quarter free cash flow deficit, protecting two quarters of dividend payments as we turn the corner to free cash flow positive at the end of our fiscal third quarter, and pre-funding bond maturities that come due next fiscal year. And importantly, we have a clear path to meet our leverage target of 3 times rent-adjusted EBITDA in the latter part of fiscal 2021.

And the third point, accelerated strategic repositioning of our US urban store base. The second pillar of our three-point bridge to the future is an accelerated transformation of the third place, adapting the Starbucks experience to cater to consumers' increasing demand for convenience.

Planning for this initiative has been underway over the past two years, and we had contemplated an implementation timeframe of three to five years, but now we're accelerating that to two to three years. This includes accelerating some store closures to pave the way to reposition assets. So again, three points: sales and profit recovery, solid liquidity position, and accelerated strategic positioning for growth.

And with that, Chris, I am happy to take your questions.

QUESTION AND ANSWER SECTION

Chris O'Cull
Analyst, Stifel, Nicolaus & Co., Inc.
Q

Thanks, Pat. I wanted to start by just discussing the path to recovery in China. The company, as you mentioned, improved its comparable sales guide for China in the third quarter. I'd like to see if you could just elaborate on what drove the better sales outlook and what's needed to get the comparable sales to flattish by fiscal year-end?

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

We could not be more pleased with how the business in China has been recovering. Of course, the first step of that was rapidly reopening stores as market conditions and government guidelines would allow, and pivoting quickly to accommodate customer's new expectations around physical distancing.

So the team moved quickly to accommodate customers how they wanted to be met, and that included dialing up our focus on Mobile Order & Pay and Mobile Order for Delivery. So as we mentioned in our 8-K, we saw nice improvement compared to pre-COVID-19 models that appeared to be fairly sticky in terms of the extent to which consumers are pivoting to more of a Mobile Order & Pay or Mobile Order for Delivery experience. So we're pleased with how the team has pivoted in that regard.

They also moved quickly to bring new products news, new innovation around both food and beverages, highlighting our commitment to plant-based milk alternatives as well as plant-based proteins. And these messages have resonated well with Chinese consumers. And as the markets increasingly open up, we're seeing good progression.

As you would expect, there is some variability across the portfolio. In those trade areas that are more tourist and transportation-related, particularly in the Tier 1 cities, we're seeing softer recovery. But we're seeing very strong recovery in commercial areas across all cities. And, overall, the lower tier cities are performing better. But we're very pleased with the progression.

Now, you asked about how we're going to achieve what our current outlook is by way of getting back to about flat by the end of the fourth quarter, and it's more the same. It's continuing to evolve and innovate our mobile offerings, including our Starbucks Rewards program where we've recently introduced multi-tier redemption, very similar to what we rolled out here in the US last year, as well as continuing to bring new news to our products, both beverages and food.

Chris O'Cull
Analyst, Stifel, Nicolaus & Co., Inc.

Q

That's helpful. Thank you. In light of your expectation for China comps to trend flat by the end of the fourth quarter, your guidance for the International segment seems to suggest a weaker recovery in Japan, even though there's – 98% of the stores are open there today. Can you speak to what is happening in Japan and how the company thinks about its recovery in comparison to what you're seeing in China?

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

A

Absolutely. The impact to Japan lagged the impacts in China. It was more towards the middle to end of March and into April that we began to see significant pressure in Japan. And the Prime Minister declared a state of emergency, which effectively put the country in near complete lockdown. And so, we had nearly all of our stores closed in Japan for an extended period of time.

And to provide a bit of insight into the impact that that has, we don't have a very high percentage of drive-thru stores in Japan. And we're not as well penetrated with mobile ordering and payment or delivery. And so, that limited our ability to capture sales during that period of near-lockdown. And that explains why Japan performed less well than either China or the US at the depth of the crisis.

It was around the middle of May that the state of emergency was lifted. And the team did a remarkable job of rapidly reopening stores in Japan, and we could not be more pleased with how the business is recovering following that broad reopening.

But because Japan is a company-owned market for us or a company-operated market, the de-leverage on that near-complete shutdown for a period of about six weeks has weighed heavily on our Q3 results in terms of both revenue and profit. And that does roll up. And that's what is perhaps weighing down the International comp compared to what some might have expected, given the very strong recovery that we're seeing in China.

Chris O'Cull
Analyst, Stifel, Nicolaus & Co., Inc.

Q

I was assuming you're expecting Japan to follow kind of a similar recovery pace maybe as China, just delayed a couple of months.

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

I don't know that it would be the same as China. We've even signaled that the US will take a bit more time to fully recover, compared to China, for different reasons. And I think it's too early to say whether Japan will recover along the same curve as China. We do expect these markets broadly to demonstrate what might be characterized as a check mark recovery or an asymmetrical V, where there's a sharp downturn followed by a prolonged recovery, but recovery nonetheless. But I think it's early to call Japan as recovering as quickly as China, maybe more in line with the US.

Chris O'Cull
Analyst, Stifel, Nicolaus & Co., Inc.
Q

Perfect. And now, I want to turn to the US recovery path. First, can you help us understand the underlying dynamics of the comp sales results in the open US stores? I know on April 28, open stores were comping down I think 25%, with half of the locations open. In your release this morning, open stores were comping down 28%, with 91% of the stores open. So are you seeing underlying improvement in the stores that have been in the pool of open stores longer, maybe just offset by more recent opening stores entering that base at a weaker level? Or are you seeing a more uniform run rate across all open stores around that negative 25% to 30% level?

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

Very good question, Chris. I think it's important to bear in mind that for a period of about six weeks we had anywhere from 45% to 50% of our stores open in the US, those that had drive-thrus or that could accommodate delivery; a very small number of cafés that were open to support first-line responders.

And so, as we very significantly and very swiftly reopened stores in the second week of May, that drove some measure of sales transfer from stores that have been open and operating during the period of [ph] wild (00:10:48) widespread closure. And that sales transfer was absorbed by the entire system as we reached now more than 95% of stores open in the US.

So as we look at the performance overall of the market, we're actually very pleased. And compared to what we were anticipating at the time that we recorded our Q2 earnings and gave some qualitative guidance in relation to US recovery, we're running ahead of expectations.

As you would expect, again much like China, there's significant variability across the country. We have some regions that are actually comping in the single digits, negative, as well as several that are in the mid-teens, negative. I would highlight the New York Metro area is the most challenged, in part because half of the stores that remain closed currently are in the New York Metro area.

So that weighs on comp performance, given that for comp reporting purposes we do fully include closed stores, which are basically at minus 100%. So a lot of variability, but overall moving in the right direction and ahead of our prior expectations.

Chris O'Cull
Analyst, Stifel, Nicolaus & Co., Inc.
Q

The company is targeting comp sales down 10% to 20% in the fourth quarter in the US, while open locations, I think, are running down 28% in the recent week. What internal or external variables are really critical for you to be able to achieve that target?

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

A

Three things, I would highlight. First of all, the high level of engagement of our partners – of our store partners and what they deliver by way of an extraordinary experience for our customers. That is the number one driver of our business.

So in addition to the improving sales, what gives us a lot of confidence is that we're seeing record high customer connection scores. Customers are thrilled to reengage with the brand, to having a wonderful experience engaging with our partners. I suppose another indication would be that tips are at an all-time high. So we're seeing strong engagement that remains on an upper trajectory. That gives us a lot of confidence for the future.

The second would be how we're quickly innovating to establish new channels of distribution in our stores. So while some regions remain under some restrictions around physical distancing, we have been able to innovate entryway pickup or window handoff in addition to where we have drive-thrus, also driving delivery with special offers through our partnership with Uber Eats. So the new channel innovation, if you will, would be the second factor.

The third would be our marketing support. We went dark in the US for a period of about six weeks. And then, a couple of weeks after we had very significantly, very dramatically ramped up store openings, more than 3,000 stores inside of two weeks we opened up for business. We then came behind that with very strong marketing support, advertising, promotions through Starbucks Rewards to reward customers for increasing their frequency, for increasing their spend; alongside that, new marketing message highlighting what we call our Summer 1 promotion. We had effectively delayed what was part of sort of a Spring 2 promotion. That evolved into a Summer 1 promotion with new product news around both beverages and food, and consumers have responded well.

So it would be all three of those levers: continued strong customer experience, given the extent to which that drives our sales; continued innovation, including things like curbside delivery in order to increasingly meet customers where they're at in the current environment; and then, number three, continued strong marketing and product innovation support. And we anticipate that continuing through to the end of the fiscal year, and that underpins our belief in the guidance we gave regarding Q4 and full-year comps for the US business.

Chris O'Cull
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Does the company believe that restaurants can fully recover their pre-crisis sales volumes without fully utilizing the dining room capacity?

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

A

It's early to say, and I think it's going to depend quite a lot based on trade area and what are the primary drivers of traffic in that trade area. For example, in dense urban metro markets that are more dependent on customer commuting traffic, where those customer patterns or behaviors have been disrupted because more people are working from home, I think it'll be more challenging to recover that traffic.

In the US, our urban stores account for about 15% of our total portfolio and we're seeing varying levels of recovery. But it is that morning peak in those particular markets that will be more challenging to recover for Starbucks. We are seeing some of that traffic move to suburban markets. If people are working from home, they're taking time out of their workday to visit their local Starbucks for the habit or the visit that they were previously accustomed to satisfying near their workplace. And then, of course, we're moving quickly to drive delivery and to open up other channels of distribution to meet customers where they are and where they want to receive their Starbucks.

Chris O'Cull
Analyst, Stifel, Nicolaus & Co., Inc.
Q

That's great. Now, Pat, I'd like to spend some time digging into the company's transformational plan to address growing demand for these on-the-go occasions. I know you described how this effort will result in a new store format. But can you describe how the customer experience will be different in one of these new Starbucks Pickup locations?

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

Yeah. And first, to clarify, we going to be picking up the pace of development compared to our previous plans for these new units. They will, however, not dominate the Starbucks landscape in these markets. These will supplement our traditional cafés to provide a range of retail formats that will best cater to the needs of customers in those trade areas.

So we do anticipate there will be a bit of a network effect here where customers can have a different type of experience depending on what their need state is in a particular market at a particular time of day, because we know that the same Starbucks customer has different experiences depending on where they're at in their daily lives.

So the same customer who might enjoy a sit-and-stay occasion at one of our cafés on a different day or at a different time of day in the same or an adjacent trade area may be looking for a more convenient option that can be satisfied by doing a walk-through basically, order ahead and pay through the Starbucks mobile app, sale through the Starbucks Pickup location, pick up their beverage and go on their way; no different from what they're currently experiencing in one of our cafés. But with the retail format, it will be less crowded and it will cater specifically to this type of occasion and that will be set up for an enhanced operating efficiency.

We'll also be able to satisfy mobile orders for delivery from these locations or other locations, traditional cafés included, in these trade areas. So we anticipate that in these densely populated urban metro trade areas that there will be a transformation of [ph] the estate (00:18:32) in the next couple of years that will include the introduction of the Starbucks Pickup stores, mixing in with existing locations, replacing some of those existing locations, which is why we also signaled an accelerated store closure program over these next two years as part of this overall transformation effort.

Chris O'Cull
Analyst, Stifel, Nicolaus & Co., Inc.
Q

Just to clarify, will the Pickup locations only accept digital orders?

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

Currently, they accept both in-store and digital. The longer-term vision would be that it would be digital-only. That's how it's set up in China with a similar concept called Starbucks Now. But it will depend on how customer behavior continues to evolve. We certainly don't want to turn away customer traffic. And we think that it may take some time for customers in these trade areas to migrate completely to Mobile Order & Pay. So we are set up currently and we anticipate the first set of units would still receive orders in the store.

Chris O'Cull
Analyst, Stifel, Nicolaus & Co., Inc.
Q

Great. Could you outline what operational efficiencies you're maybe able to capture with this new strategy of introducing Starbucks Pickups to markets maybe in terms of how it reduces congestion? And do you, ultimately, expect the ability to increase off-premise throughput in these markets where you introduce these new formats?

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

We do; we do. The reality is that when you set up a coffee bar that is in plain view of the customer, it's not set up for maximum operating efficiency. And so, one of the benefits of the Pickup location where the beverage preparation still handled order by order, customized to what the customers' preferences are, still prepared by hand, handcrafted every single beverage, that happens behind the wall, if you will, out of view of the customer; and it could be set up more like an assembly line, thereby supporting more rapid preparation. And that brings inherent operating efficiency. And then, of course, with what would be a smaller asset overall without seating area, that enhances the fixed cost profile of the store, which further contributes to an improved margin profile.

Chris O'Cull
Analyst, Stifel, Nicolaus & Co., Inc.
Q

Will the results at the Pickup store alone be used to evaluate whether it's an investment success or will there be more of a holistic approach to the total sales across, say, the Pickup store in the one or two traditional locations that it's situated between?

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

It will be a holistic approach for sure. And that speaks to the complexity of the analysis and a bit to the pacing of our rollout as well, because we fully expect to learn as we go and to further refine our plans in relation to the specific locations, the setup, the interplay between these different formats based on how customers are continuing to evolve their behavior.

But we are looking trade area by trade area, taking into account sales transfer dynamics as we close stores and then reopen. And in many cases, what we're looking to do is not close stores until we have opened the new store that we expect to receive sales from that closed location, recognizing that not only the new location, but other existing locations in the trade area will be the beneficiaries of that sales transfer.

So, I feel very good about the extraordinary data analytics capability that our team has developed and the ability to rapidly learn and adjust as we go as we accelerate these plans over the next couple of years.

Chris O'Cull
Analyst, Stifel, Nicolaus & Co., Inc.
Q

Are there insights that have led you or led the company to conclude that the overall sales potential for the trade area, once you introduce one of these new locations, could increase as a result of adding the distribution point or is this more of a tactic of trying to maintain the sales that you have in those markets?

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

A

We expect to see sales go up for two reasons. Number one is that as we introduce a more efficient format that has a higher level of productivity that can serve customers faster, we will reduce the balking that can at times occur in these urban locations because of the natural speed, if you will, of the current traditional format. So we do expect to be able to unlock sales through improved efficiency.

The other would be – is that with a more nimble asset format, we can gain retail presence in certain trade areas or sub-trade areas that we couldn't previously with our more traditional format. We do expect that in the near term, as we accelerate these efforts, that we will see pressure on sales and that would be in fiscal 2021, but that we would then re-accelerate in fiscal 2022.

So as a consequence of the closures and the timing of the closures in relation to the openings, we would see a near-term revenue decline in those trade areas, however, enhanced profitability, because we're effectively trading out less profitable stores, in some cases, unprofitable stores with much more profitable stores. So, we're solving for the bottom line as we're solving for the top line in terms of maintaining our share and growing our share over time while enhancing the profitability of the business.

Chris O'Cull
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Okay. We did get a question come across from listeners. The question relates to the planned – or planned closings for – the 400 planned closings. And I think the question essentially is trying to get to what do you expect the net addition or net opening rate to be when you incorporate the number of openings versus closures over the next 12 months?

And then, I know, longer term, the company guided to 3% to 4% unit growth in the US. Is that the net addition rate or is that the opening rate?

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

A

So, I'll speak to the net new store growth rate, because it's on that basis that we guide. And you're right, our long-term growth model calls for 3% to 4% net new store growth in the US and for the Americas business segment. We expect to be on that pace in fiscal 2022. We will not be on that pace in fiscal 2021, but we expect to be positive, but it will not be 3% to 4% because of the volume of closures that we're pulling forward in both the US and Canada. So we will provide more explicit guidance for fiscal 2021 when we provide our full range of guidance for next fiscal year in conjunction with our Q4 earnings call.

Chris O'Cull
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Perfect. Many people believe working from home will become the new normal for at least a portion of the US workforce. Does the repositioning of stores help reduce reliance on commuter business?

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

It does. It does to some degree in part, because we're right-sizing our assets to meet the type of demand that we expect in the metro markets. And as I mentioned earlier, we're seeing some pickup in residential drive-thrus catering to people who are working from home out of the cities. But we also know for a lot of professionals, who work in the cities, they live in the cities too and their Starbucks location, because we're well penetrated in those markets, that it was closer to where they live and the city is benefiting from some business that they didn't have before, while the location is closer to maybe the commercial centers are experiencing some pressure and that is all figuring into what we call our trade area transformation strategy for US urban markets in the next couple of years.

Chris O'Cull
Analyst, Stifel, Nicolaus & Co., Inc.
Q

So I know Starbucks, their approach is always holistic and very comprehensive and thoughtful when they implement new strategies like this. I mean in this environment with less commuting, what other changes does the brand potentially need to make beside just the store format or the location to remain relevant in an environment with less commuting?

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

Well, less commuting means that consumers may be consuming in a different trade area because they're not commuting to their office, but they're closer to home. So whether continuing to build drive-thrus in suburban markets and that remains a significant element of our longer-term growth strategy in the US, given the penetration levels – relative penetration levels in suburban markets or the advent of curbside delivery or at-home delivery, because with our partnership with Uber Eats, we've seen some growth not to the extent that we've seen in China, but nonetheless, encouraging growth in our delivery business. And we do believe that that is something that will grow over time.

So, it's by continuing to innovate the retail format to offer convenience to consumers who are as you mentioned – or maybe increasingly working from home or also meeting them at their home with that occasion through delivery.

Chris O'Cull
Analyst, Stifel, Nicolaus & Co., Inc.
Q

What would it take for the company to accelerate growth in the delivery channel, particularly in dense urban settings? Is it packaging, delivery kitchens, maybe commission rates that are different?

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

I think it's going to be customer behavior. We're just not seeing broad customer acceptance of or migration to a delivered beverage occasion. Again, very different from what we're seeing in China, but we have seen improvements as we've gone to national coverage and certainly helped by some of the more recent promotions we've been doing in partnership with Uber Eats.

So I just think that the delivered beverage occasion compared to the delivered meal occasion, it doesn't seem to be as relevant to customers in the current environment. But we know that customers are dynamic. We know that, over time, they're looking for more convenience. So we anticipate that this is something that will grow over time.

Chris O'Cull
Analyst, Stifel, Nicolaus & Co., Inc.

Q

What do you believe are the biggest obstacles for consumers desiring coffee delivered or beverages delivered?

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

A

It could be, as you mentioned, the commission in relation to the ticket size. So, commission having a fixed and variable component in relation to the ticket size for a full meal, it's a more attractive economic proposition from a consumer perspective, less so for a single beverage.

Now, we are seeing, in our delivery business, an increased order size, oftentimes with higher rates of food attach, which speaks to the fact that people are looking for a delivered meal or they're doing group ordering. In either case, I think that demonstrates that they may be focused on how they can maximize the return on their investment and the delivery fee and/or commission.

Chris O'Cull
Analyst, Stifel, Nicolaus & Co., Inc.

Q

As you mentioned and Kevin mentioned in the bridge to the future letter, he called out more drive-thrus as a possible result of the repositioning. I think about 60% of your US company stores currently have a drive-thru. So, how much could that increase by that mix increase in the US?

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

A

Well, I think the best way to respond to that question is to highlight the mix of our new store development that is drive-thru, which is around 80% and that may increase over time. So, as you're mixing in new stores at a much higher rate, that should give some indication as to how we would expect that overall percentage from 60% to continue to increase over time.

Chris O'Cull
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Great. And then, we did have a couple questions come through, one regarding portfolio optimization outside of the US. How do you foresee the portfolio optimization unfolding outside of the US for licensed locations? And overall, what is the CapEx you're allocating to this optimization effort?

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

A

So, outside the US, in our company-owned markets, we are already evolving in China with the Starbucks Now concept, about 10 units opened today, another 40 to 50 will be added between now and the end of the year I believe. So, some nice progress there. I don't know if that's so much trade area optimization as it is mixing in a new format in a high-growth market in a way that continues to cater to the growing customer needs state of convenience.

In our other markets, company-operated markets like Japan and the UK, I think it doesn't seem to be as much of an opportunity currently compared to what is so compelling in the US, given the current profile of our retail presence in dense urban markets. So, I don't know that there is as much of an opportunity there, plus those are much smaller markets.

What I would highlight and it was mentioned in our 8-K, not so much portfolio optimization from the standpoint of how we mix in new retail formats, but we did highlight for Canada, which is another company-operated market, that we will be pursuing a restructuring of that business in the next two years and that would involve the acceleration of up to 200 store closures. And that is more about addressing underperforming locations and consolidating our operations there in a fashion that will improve the overall profitability of that business.

Chris O'Cull
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Just to stay on licensed location – or to talk about licensed locations briefly, how has the crisis changed the returns on new licensed units? And have licensees indicated they maybe are planning to alter their growth plans either in the US or Europe? And also, can you talk a little bit about what kind of relief you've been able to provide them and how long that may persist?

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

A

No change to long-term growth plans or expectations, because our licensees believe, as we do, that the current circumstances are temporary. There will be recovery in time. It may take longer in some markets versus others, but the early indications are that consumers have deep love for Starbucks. They're intensely loyal. They can't wait to reengage. And over time, as markets open up and people adjust to the new normal and as we provide the safe experience that our partners and customers expect, we and our licensees expect that the new unit returns will remain very attractive and, therefore, no change to long-term growth expectations.

But the near-term impacts are significant, as we've disclosed for our third quarter, at the depth of the crisis, the month of April in particular, but then continuing, but abating in May, and now, of course, we're anticipating June to be closer to breakeven and then free cash flow positive by the end of our fiscal third quarter end of June. So, things are moving in a very positive direction.

But because of those temporary circumstances, we saw the need for some of our licensed partners for additional support. We deferred payments on outstanding receivables to provide cash flow relief. We granted flexibility around inventory ordering. We granted flexibility around development commitments and renovation commitments, not [ph] erasing (35:07) those commitments, but getting some flexibility around timing and meeting those commitments.

And then, the other thing we did in Q3 alone was [ph] we took the (35:15) quite extraordinary step of granting a royalty holiday to our international licensees. So, not just the deferral of royalties owed, but in view of the impacts to markets around the world, we granted a complete holiday. That means no royalty income on licensee sales in Q3. That's fully reflected in the guidance we provided this morning for Q3 EPS.

We feel very good about steps we've taken to take care of our licensees as important business partners as well as some of the other stakeholders. We've taken care of our partners making significant investments, industry leading investments around partner care during the time of crisis and that is reflected in our Q3 operating results. But we feel good about those investments consistent with our mission and values as a company and we remain very confident that there will be a strong return on that investment in the form of partner engagement and customer goodwill. So, licensees, they are another stakeholder group important to us and we saw the need and our ability to make meaningful investments to further deepen the partnership.

We also took steps to protect key strategic suppliers by accelerating payments to them during the time of crisis. My Treasurer has reminded me that it put us in an interesting squeeze position where we deferred receivables, but accelerated payables, but that was something we did knowingly and intentionally in order to take care of licensed partners, supplier partners as well as our store partners and then, of course, the communities we serve through very significant grants around community service.

Chris O'Cull
Analyst, Stifel, Nicolaus & Co., Inc.

Q

Great. And then, just one last question and we've heard the company describe the Global Coffee Alliance as one of the more underappreciated aspects of the company. Prior to the crisis, I think, guidance called for the Channel Development segment to contribute more significantly to total revenue growth after fiscal 2022 than the 4% to 6% intermediate term rate. Has the crisis altered the outlook for this business in any way?

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

A

Not materially. There have been a couple of things moving in opposite directions. We announced earlier this year a modified relationship with KDP in relation to the pod manufacturing in conjunction with our Global Coffee Alliance with Nestlé, delivering favorable economics this year, flowing through the Channel Development business. That has been offset by relative softness in the foodservice channel of the Global Coffee Alliance. Think hotels and universities where foodservice is provided. Those channels have been under pressure.

And then, of course, that has been somewhat offset by the tailwind in grocery stores who saw extraordinary sales in the third quarter. So, things moving in different directions pretty much netting to flat versus our prior expectations. We're really pleased with the progress we're making through our Global Coffee Alliance with Nestlé to expand the presence of the Starbucks brand in so many markets around the world and in partnership with Nestlé and their world-class innovation, bringing forward new products that are helping to grow the overall business.

So, no change versus prior expectations.

Chris O'Cull
Analyst, Stifel, Nicolaus & Co., Inc.

Great. And, Pat, I want to thank you again for your time today. This has been a very helpful discussion and we look forward to hearing about how the business is progressing when we have the opportunity to speak again. But, again, appreciate your time.

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

Thank you. My pleasure. Appreciate you hosting Starbucks for this conference. Have a great day.

Chris O'Cull
Analyst, Stifel, Nicolaus & Co., Inc.

You too.