03-Dec-2019

Starbucks Corp. (SBUX)

Morgan Stanley Global Consumer and Retail Conference

CORPORATE PARTICIPANTS

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

OTHER PARTICIPANTS

John Glass
Analyst, Morgan Stanley & Co. LLC

MANAGEMENT DISCUSSION SECTION

John Glass
Analyst, Morgan Stanley & Co. LLC

Good morning everyone. Thanks for joining us. My name's John Glass. I'm the restaurant analyst at Morgan Stanley and on behalf of all of my colleagues at Morgan Stanley welcome to our Global Consumer Conference. Welcome to our 25th Global Consumer Conference. It may or may not be, we don't know, but it's been here a long time, and so we appreciate it. Now, we did move it back this year in the calendar to December to accommodate some of the retail companies. So hopefully that's productive for you.

So thank you for your attendance and I also particularly appreciate both yours and company's attendance given the weather and the challenges that presented. It's also my pleasure to introduce our first company at the conference, Starbucks. I'm going to turn over the podium in a moment to Pat Grismer, the CFO. But I've had the pleasure of following Starbucks nearly from its IPO and watch this company grow from a 200 or 300 unit, back then we called it a retailer to really the global behemoth that it is today. Pat is going to make a few opening remarks and then we'll sit down and have a more informal chat about the business.

So with that, welcome Pat. Thanks for coming out.

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

Thank you, John, and good morning, everyone. And John I'm happy to see you are proudly displaying your Starbucks cup. There are a couple of points I'd like to highlight just ahead of our fireside chat. First of all, this is a global consumer and retail conference. So I'd first like to highlight the unique investment characteristics of Starbucks in the global retail, food and beverage space. And then, secondly, the improved quality of earnings that we expect in our fiscal 2020. But first I would draw your attention to the Safe Harbor statement on the screen, because I will be making some forward-looking statements this morning.

Our proprietary consumer and brand equity research substantiates the strength of the Starbucks brand, maintaining our competitive edge in our two lead growth markets of the US and China. And we're building on those brand strengths with focused strategies to drive predictable, sustainable sales growth. In the US, Starbucks remains the clear first choice among retail coffee brands including independent and local concepts. Our research has also validated that younger consumers in particular have a strong liking for Starbucks, this includes millennials and centennials, and this bodes well for the future of our brand. And in China, Starbucks continues to be customers' first choice for away-from-home coffee, leading the competition on all key brand attributes.

Our customers' exceptional affinity for the Starbucks brand is deeply rooted in the unique connections that our partners make with our customers. And we're taking decisive steps to further elevate the in-store experience, to create those best moments that uplift the everyday. Starbucks has further differentiated on the basis of our ability to provide premium coffee, craft, and consistency at scale often supported by proprietary breakthrough beverage innovation. Examples include, Nitro Cold Brew as well as Cold Foam Cold Brew. Most recently our hugely popular Pumpkin Cream Cold Brew, and just announced today our new Irish Cream Cold Brew, a festive twist on a customer favorite.

And finally, Starbucks has industry-leading digital platforms that we are continuing to enhance to accelerate digital customer engagement. In the US, our research confirms that Starbucks leads in having a mobile app that meets consumers' needs. This is helping to fuel the growth of our Starbucks Rewards loyalty program where 90-day active member base grew year-over-year 15% to more than 17 million members at the end of our fourth quarter. This is an important driver of growth because we know from our experience that when customers join our rewards program their total spend with Starbucks increases meaningfully. Our digital success has been equally compelling in China where our loyalty program awareness and conversion metrics exceed those of our competitors. Our [ph] upleveled (00:04:30) Rewards Program was launched a year ago and our 90-day active loyalty base in China grew 45% year-over-year to 10 million members at the end of our fourth quarter.

The strength of our brand and the effectiveness of our growth strategies are reflected in a superior growth profile. Compared to other large scale global brands in the retail food and beverage sector Starbucks is growing system-wide sales – system-wide stores at a much faster rate. Globally we're expecting robust net new unit growth of 6% to 7%. This includes 3% to 4% net new unit growth in the US, which is industry-leading for a concept of our size. Importantly, Starbucks is the only brand at this scale, which has grown store count in the US in the past three years. And still Starbucks is far from full penetration in our home market expanding in the central and southern regions of the country primarily with high volume drive-throughs.

This stronger pace of development for a concept of our scale is enabled by the substantial investment returns that we realized through new store development. So let's look at the facts. As a beverage forward concept we enjoy a relatively high product margin coupled with limited kitchen investment. Our margin is further enhanced by our unique brand stature that generates unpaid media exposure reducing our need for advertising expense compared to other concepts. These unique economic characteristics yield overall investment returns that are very attractive and act as a catalyst for shareholder value creating company store development in our two lead growth markets as well as asset free license store development everywhere we operate.

Moving on to our outlook, for fiscal 2020 non-GAAP EPS growth where we expect the quality of our earnings growth to improve compared to fiscal 2019. Now, as a reminder, our non-GAAP EPS growth in fiscal 2019 was 17% and it was lifted by several non-operating items including unplanned tax favorability with core operating results contributing 6 points of growth. At the midpoint of our non-GAAP EPS guidance for fiscal 2020 a more modest rate of revenue growth is expected to more than offset stronger margin performance reversing a trend from the last three years. This yields 9 percentage points of EPS growth from operating results at the midpoint of our guidance, up 3 percentage points from the prior year.

And when excluding the impacts of various non-operating items like tax and streamline and foreign exchange our non-GAAP EPS growth rate in fiscal 2020 is expected to be 12% at the midpoint, which is in line with our long-term growth model of at least 10% non-GAAP EPS growth. So in closing, with Starbucks exceptional brand strength and superior growth profile, we are confident in our ability to deliver our long-term growth algorithm of double-digit EPS growth coupled with a dividend yield of approximately 2%, which is quite compelling for a double-digit grower. This concludes my opening remarks and I'm now happy to John – join John for our fireside chat and thank you for your attention.

QUESTION AND ANSWER SECTION

John Glass
Analyst, Morgan Stanley & Co. LLC

Q

Thanks very much, Pat. I wonder if we can start by talking about the US business and you alluded to success with some of the new beverage innovation but I think the question we often get as analyst and investors ask is, you've seen meaningful step-up in the performance of the US comp store sales the last two quarters on a one and two year basis. And many of the things you've been doing over the past year have been present all along. So what has really driven that material step-up in the momentum of the business? If you can sort of walk through the two or three things you think are most contributing most to that improved performance relative to say, three or four quarters ago.

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

A

Well, for us it really has been more of a journey. We're very pleased with the steadily building momentum in our business on the back of significantly increased focus and discipline across every dimension of our business. This includes the three pillars that I mentioned previously, the in-store experience, beverage innovation and digital customer engagement. And it has been a steady stream of activities across each of those pillars that collectively have yielded this increased momentum and I'll cite as an example, the rollout of Nitro Cold Brew. So we were rolling out Nitro Cold Brew equipment across our company-owned store portfolio for the last 12 to 18 months.

We achieved 80% penetration in the US in August which gave us the ability then to go on air, to advertise, to build awareness around the Nitro Cold Brew platform and its unique characteristics. We achieved full penetration by the end of our fiscal year. So that's an example of the type of activity that has been rolling out over a period of time providing us with this upward momentum for the last couple of years following what had been a couple of years of relatively uneven performance. Our goal in all of this is to lay the groundwork for a predictable, sustainable growth over the long-term.

John Glass
Analyst, Morgan Stanley & Co. LLC

Q

That's helpful. Can you talk a little bit more specifically about beverage innovation? It's a beverage forward company. So a couple of years ago I think there was a pivot towards food thinking that food maybe was an answer and I think maybe one of the insights maybe more recently has been more focused on beverage. But can you talk a little bit more about how you see those – that beverage platform unfolding? And in particular cold beverages have been driving your business. Is there a concern as the cold weather months around the corner or here now you're launching a cold beverage platform Irish Cream today, does that diminish the impact of cold beverage or is that about the right way to think about that?

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

A

Well, first with respect to how we have thought about innovating behind beverages versus food, the first part of your question. There's no doubt that food remains an important part of what we offer. But as I mentioned before one of the aspects that – of our business that has been instrumental to the overall positive momentum that we've witnessed for the last 12 to 18 months has been focus and we've taken our product innovation resources and focus them more around beverage as opposed to what traditionally had been split between food and beverage. We recognize that we are a beverage forward concept. Beverage is our key point of differentiation. It contributed 5 of the 6 points of comp sales growth in the most recent quarter in the US.

And so, by applying more focus and more resource to beverage innovation and driving more consumer research to drive more insights around what is going to resonate most with our customer base particularly young customers we've identified those insights that have allowed us to introduce new products that have performed better than in earlier years. And I would say, out of that has come significant insight around cold beverages which have figured quite prominently in the growth of our beverage platform in the last couple of years. And this speaks to what appeals to young people and also what resonates across all dayparts.

Cold beverages had performed very well for us not only in the afternoon or as you would expect during the warmer months but truly year-round and even in the morning hours where oftentimes consumers are looking for something that is more refreshing not necessarily something that is strictly hot. In response to your question then – around whether we're seeing any pressure on hot beverages, we continue to see growth in our hot beverage platform and so we're seeing growth across the entire range of beverages and we remain very pleased with the insights that we're gaining that we're able to capitalize in the way that we introduce new product news.

The other thing I would highlight that has changed from two years ago is that we were previously more reliant on limited time offer beverages or what we called Sparks, which drove spikes in our business and cost a lot of disruption in our store operations. And so the approach that we're taking today is to land a more innovative beverage platforms around which we can innovate going forward, so Cold Foam would be a perfect example of that. We used Cold Foam to launch our Cloud Macchiato platform. We introduced Cold Foam with the hugely popular Pumpkin Cream Cold Foam beverage that was part of our fall lineup and Cold Foam is the key differentiator for the Irish Cream Cold Foam that we launched just today. So those are some examples of how we have introduced platforms that help us introduce new innovation in ways that don't drive a lot of disruption in our stores.

John Glass
Analyst, Morgan Stanley & Co. LLC

Q

And then just finally on that topic, can you talk about the afternoon business rate that was a big hole in the business since Frappuccino's appeal waned over the last few years. Have you recaptured those afternoon sales or is that still a drag on the comp? How do you characterize how the afternoon business has done in the last few quarters?

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

A

So afternoon daypart had been a challenge for us for many years in many ways because of the strength of Frappuccino several years ago, and as consumers were looking to pivot away from the more indulgent beverage, we saw Frappuccino sales decline and that weighed particularly on our afternoon daypart. What has happened is two things. Number one, the reduction or the decline in Frappuccino sales has plateaued. It's still a meaningful part of our business but we're not seeing the rate of decline that we'd seen in previous years; and at the same time we've been very successful with what we've launched by way of new cold beverage – beverages that have taken up some of that demand so not just Nitro Cold Brew or Cold Foam Cold Brew but also our Refreshers line and our line of flavored iced teas. Those have all performed really well and have contributed to the turnaround in our afternoon business for the last two quarters.

John Glass
Analyst, Morgan Stanley & Co. LLC

Q

That's very helpful. I want to pivot down to digital and a couple of questions on digital. Starbucks really I think pioneered in many ways the digital relationship it has with its customers through its loyalty program – now it's transformed in Mobile Order & Pay and ultimately to delivery. You have changed that loyalty program that which is sort of a keystone in that a couple of times, right, migrated from kind of the value of Stars and now you've changed it again to the redemption levels. I think that was done third quarter, the June quarter, if I got that correct? So how has the response been to that? Has that going smoothly? Has that actually increased utilization as you had hoped of the digital and the loyalty program?

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

A

We could not be more pleased with how our re-launch of Starbucks Rewards landed in April so with the start of our third fiscal quarter as you mentioned. And the structural change that we made was one that increased the flexibility with which Starbucks Rewards or Stars are both earned and redeemed. Previously one of the friction points in loyalty program membership was a green tier where customers needed to accumulate 300 Stars to reach Gold status and then had to accumulate another 125 Stars in order to start redeeming. So with the introduction of multi-tier redemption or MTR as we call it in April we removed that green tier and we allowed customers to start redeeming with as few as 25 Stars, and we expanded the range of products available for redemption.

So a range of redemption levels from 25 Stars up to 400 Stars including merchandise and at home coffee purchases and we've seen significant positive customer response to this change, which was exactly what we had designed for because in fact there was significant customer research that went into the program design and a significant effort to educate our partners and customers about the changes, so that there wasn't a surprise and so the customers and partners alike could understand the value that is unlocked by providing this level of flexibility and so on the back of that program we have seen improved customer engagement with the loyalty program.

We've attracted more what we call occasional customers into the program, which means that they don't visit Starbucks as frequently which for us creates significant opportunity because we know from our experience that as we migrate customers from what we call digitally registered into full rewards members, we see their spend increase substantially. Now, I would highlight this change as something that has more of a flip-the-switch impact to our business as opposed to the steady build that I was mentioning earlier because from the moment we turned on that program, we saw these positive results start to accumulate.

The other thing I would mention is that when we introduced MTR in April, we took the opportunity to introduce enhanced – an enhanced personalized marketing engine into our technology stack and the importance of this is that it allows us through machine learning to gain increasing insights around what matters most to our customers, which informs the offers that we make to them digitally. And on the back of these enhancements, we have seen the contribution from digital customer engagement increase from what had been closer to 1% comp to 2 points of comp in the last two quarters.

John Glass
Analyst, Morgan Stanley & Co. LLC
Q

And just to be clear on that, that you said it was an immediate impact when you changed and that was result of new non-users of the loyalty program coming in or was there a spend increase? I think one of the observations early on about loyalty was your loyalty users were spending more and that was driving a lot of back when traffic was more scarce, check was really driving your comp, and [indiscernible] (00:18:54) impact was driven by loyalty members. Is that still the case or are you seeing this new program actually resulting in traffic or some other manifesting itself some other way in comps?

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

We are seeing both. So we are seeing, as in the last quarter, a 15% increase on acceleration and the growth of our membership base and we are seeing increased frequency.

John Glass
Analyst, Morgan Stanley & Co. LLC
Q

Before leaving the US, I want to ask about delivery. It's obviously an important topic in the industry. I think there's still a debate as to what delivery ultimately yields the restaurant industry. In particular for Starbucks, remind us where you are on delivery? And more importantly, how do you think about this business or is this a – we're going to see [indiscernible] (00:19:36) to see because we don't really understand what the use case may or may not be for delivering coffee.

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

Well, I'll talk about delivery with respect to our two lead growth markets, because we're seeing a different profile of delivery business in the US versus China. In the US it's a slower build. I think in part because compared to food and beverage delivery generally we are at a lower ticket. And so, the delivery charge is a higher percentage of ticket and probably acts as a bit of a barrier to utilization of delivery for beverages only. So we have – we are very pleased with the program that we've established in partnership with Uber Eats. We selected Uber Eats because of their national coverage and we do expect to achieve national coverage of our stores with delivery in fiscal 2020. But it has been a slow build. So we aren't seeing it mix at a very high rate.

What we are getting we are seeing incrementality which is important because delivery transactions on the margin are margin dilutive because they include additional costs, both the delivery commission as well as packaging. But if the delivery transactions are highly incremental then we're growing total profit even at the expense of our margin percentage. But it's early days in the US, as I mentioned we're seeing a slow build. But we expect that over time this could increase as consumers are increasingly looking for convenience. The other thing I would highlight is that we're seeing with our delivery transactions significantly greater average check, and that's because with delivery we see higher rates of food attach than we see in our stores.

And we're also seeing higher average party size, particularly in an office environment where if one individual, if one customer is sending out for Starbucks chances are others will hop on to the order. So I contrast that with China. China, we launched delivery a little over a year ago in partnership with Alibaba and we've seen a nice steady build in that business. In the most recent quarter delivery mixed at about 7% of our total sales and we're seeing that in China as opposed to the US consumers perceive this as offering even greater value because of the value they place on convenience and having the beverages brought to them. So I think it's a more established use case, it's a more established customer behavior, and we're seeing that in the way that our business is building there. But as in the US those transactions come at a slightly lower margin for the reasons I mentioned but we're seeing nice incrementally to an extent that builds our total profits.

John Glass
Analyst, Morgan Stanley & Co. LLC

Q

And I want to pivot to China but just as we think about the difference in delivery between the US and China how different are the economics both to you and the consumer? Is it popular or growing faster in China because it's just a better value proposition to the consumer? Is it relative to the size of the check and how the economics look at to Starbucks deliver US versus China?

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

A

So from a consumer perspective I would say that the value proposition given the commission structure is more attractive than in the US, and I would say from a company perspective there are also differences in the commission structure such that the profitability of those delivered transactions is longer in China than in the US.

John Glass
Analyst, Morgan Stanley & Co. LLC

Q

I want to now talk about China as a whole, and before maybe getting into the details – the competitive landscape in China has been a subject of debate, right, large market obviously, an attractive category usually attracts competition and you've got one competitor in particular it's grown rapidly and has the results recently have been relatively strong. Your results by the way at least through the last couple of quarters have also been strong. What have you learned? What Luckin taught you about the business in China? What lessons do you take from their successes to the extent [ph] you observed (00:23:42) them and how is that reflected differently now in your business?

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

A

Well, the way I think about it is that Luckin has validated what we've known for years, which is that the specialty coffee retail category in China is very attractive and has significant growth potential. And I think that this is particularly striking for a culture like China that is based in tea drinking. But for many years now Starbucks has demonstrated the growing appeal of premium coffee. When you look at the statistics in the US, per capita coffee consumption is around 300 cups. In China, it's fewer than four cups. So there's significant headroom for growth, and Starbucks has demonstrated again the appeal and the growth potential of that category and that has attracted, our success has attracted a lot of competitors, Luckin being one. I think it is also important to put Luckin's performance into perspective.

They frequently highlight the number of points of distribution that they have opened in China. But they also, I think clarify that more than 90% of those points of distribution are pickup locations. They're very different from the third-place environment the premium experience that Starbucks offers. We feel very good about the position that we've staked out competitively in China, the first-mover advantage that we've gained with our strong brand awareness and brand affinity and we believe that the space is large enough today and in the future to accommodate this competition. In many ways, the competition has helped to build further awareness of specialty retail coffee. It has grown the category and we believe that with our points of differentiation around premium coffee and a premium third-place experience that we will continue to thrive.

John Glass
Analyst, Morgan Stanley & Co. LLC
Q

Do you think though – I mean they do – it's not just that they are in the category with you. They approach the consumer relationship differently, right? It's all digital, a lot of it's – pickup and delivery itself. There is a lot – it's a different and the pricing is very different that there isn't [ph] really set (00:25:46) menu pricing. Has that – those experiences changed the way you think about how you want to engage in the consumer? And I guess to that point you've changed – now you've got Mobile Order & Pay now in China, you hadn't had it really before Luckin materialized you. You've been doing, I guess, what Starbucks Now stores, which are these more pickup, so maybe can you talk about things that are – you are evolving, maybe it's just that the consumer is there and how Starbucks has responded to those changes in the consumers?

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

We feel very good about our track record of innovation in China. We have continued to evolve as a concept and innovate along with the Chinese consumers and their growing and evolving tastes and preferences. Yes, it's true, in the last year we have made significant progress on the digital front. It was, as I mentioned, a little over a year ago that we established our partnership with Alibaba and used that as a basis for launching delivery, which has added a meaningful layer to our business. It was about a year ago that we also re-launched our loyalty program moving to a spend-based loyalty program.

And as I mentioned earlier in the most recent quarter now lapping the nearly one year launch of that program 45% growth in our loyalty base. And then finally, as you mentioned, more recently I think starting in the month of May we rolled out our Mobile Order & Pay and through the end of September we were already in two-thirds of our stores across the market and we're seeing nice customer acceptance of that offer. And in the summer we innovated our very first Starbucks Now pickup and go location. We opened our second location recently in Beijing and we expect to open many more in the coming fiscal year. So I think that this is more of a continuation of what has been a long rich history of innovation and evolution of the concept to meet the evolving tastes of customers.

The other thing I'd want to say, again, just to put Luckin's business in perspective and as much as they have talked about their points of distribution in the most recent quarter and of course this information is now available to all their total sales were about one-third of Starbucks total sales. So, yes, increasing points of distribution, a significantly lower average unit volumes. And I think it's fair to say based on what it is they offer customers, they're going after a different customer, they're going after a different occasion. We feel very good about the position that we've [indiscernible] (00:28:02) premium coffee and a premium experience and we believe that we're well positioned to further capitalize on that as the category continues to grow.

John Glass
Analyst, Morgan Stanley & Co. LLC
Q

And then just finally on China, you framed your comp guidance for this year and the long-term still at 1% to 3%. You've been running 5% to 6%. What is the hesitation and whereas I think your outlook for the US although the range [indiscernible] (00:28:23) change obviously has been emboldened by recent trends. What is the hesitation? Is China just less certain around where the outcomes could be or do you see something you get concerned about as you looked into the back half of 2020?

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

There has been variability in the performance of our China business in the last couple of years. In the most recent two quarters we were lapping some weaker performance arguably and we feel that a target of 1% to 3% in the current environment is prudent for three reasons. We've highlighted before that our overall rate of comp sales growth has been impacted by three things. And that explains why it – we're guiding to the low-single digits as opposed to what had traditionally been mid-to-high single digits. Number one is that we have picked up the pace of new unit development. And with that comes cannibalization and we're doing that because again we see the significant growth potential in the market and the opportunity to capitalize on the strength of our brand position.

So the first piece is we're effectively doing it to ourselves, we're doing it intentionally in the interest of growing total transactions and total sales. Number two is that as I mentioned before our success has proven the attractiveness of the category and has drawn a lot of competition. That's impacting us on the margin. No one particular competitor but the competitive set in the aggregate has intensified, has grown and it is impacting us. And the third is in the last two to three years, the rate of economic growth in the market has slowed. It's still pretty healthy at around 6% but that's down from where it was previously and that is impacting retail footfalls, and that is another contributing factor to – a low-single-digit comp sales growth which we feel is a prudent long-term guidance for that business.

John Glass Q

Analyst, Morgan Stanley & Co. LLC

I want to just ask briefly now on the global coffee alliance, an important part of your business in the CPG or Channel Development business, and that is 18 months ago you sold or you licensed the business to Nestlé to distribute your packaged coffee around the world. Can you talk just about where you are standing now 18 months later in terms of the growth of that business? And I know there is a dynamic in 2020 on revenue growth. Just want to make sure we understand what the headwinds and tailwinds are in 2020? And how we should think about the growth of the CPG or the global coffee alliance going forward?

Patrick J. Grismer A

Executive Vice President & Chief Financial Officer, Starbucks Corp.

So, we could not be more pleased with how the global coffee alliance with Nestlé has landed in terms of what it has done to accelerate the penetration of the Starbucks brand in international markets. In the first year of the alliance, we expanded to more than 30 markets and we expect to get up to 50 markets in the first half of fiscal 2020. That is much faster than we could have ever penetrated those markets on our own. So we're pleased with how that is building the awareness and the presence of our brand globally in CPG channels.

It isn't showing up in our revenues. In fiscal 2020, the way that we expect it to show up much longer-term because there is a headwind from some of the inventory building that was done in fiscal 2019, so we're overlapping that in fiscal 2020. And we do expect that as we accelerate the pace of international market penetration, our royalty income will grow. So we had outlooks for the channel development business in our long-term model, revenue growth of 4% to 6%. The way I would segment that is in the near term it's more 4% to 5% and the medium to long-term it's 5% to 6%.

John Glass Q

Analyst, Morgan Stanley & Co. LLC

Got it. That's very helpful. And then finally, let's talk a little about the financials. You highlighted the earnings model that company has at least 10% earnings growth and how you're going to see higher quality earnings growth in 2020. And I think your comment was around margins. Can you talk about what you think the margin potential in this business is? I think a year ago you framed it at 17% to 18% operating margins. But historically it's been higher and there's been some changes in the structure of the business. But what is the longer term opportunity in margins? Is it the kind of business where you'd like to manage it to those margins, the reinvestment and reinvest – continue sort of competitive advantage or maybe talk a little bit about where you think those targets can be?

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

A

Absolutely. Where we start is around what is necessary in order to sustain long-term healthy top line growth. And one of the things we know about our brand is that it requires a level of investment to maintain clear points of differentiation around our partners and technology. And so, that does come at the expense of margin. I feel – still feel very good about the margin guidance of 17% to 18% for the next three years. That's not to suggest that we don't have the potential to move beyond that. But it really comes down to how we think about balancing the need to invest, in particular, behind partners and technology to sustain top line growth that provides us the sales leverage that helps to pay for those investments and cover inflation. I would also say that we continue to be very diligent in finding productivity opportunities at store level and above store to create more capacity for the investments that again we now are instrumental to our ability to sustain that predictable, sustainable top line growth.

John Glass
Analyst, Morgan Stanley & Co. LLC

Q

Can you just talk a little bit more specifically about where the larger opportunities are? I think a year or so ago G&A was a target and you had a hard number of, I think, it was a $1.7 billion by 2021 and now it's changed a bit, maybe part of its the re-segmenting of the business, part of it is maybe you've just explored other options around supply chain, so where do you see the biggest buckets in terms of opportunity as we look at your P&L?

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

A

So the opportunities remain in G&A and we remain committed to delivering those efficiency gains that were identified a couple of years ago and that will play out through the end of fiscal 2021. You're right, the re-segmentation has clouded that a little bit but nonetheless in the guidance that we provide we continue to expect significant efficiency gains in G&A that will show up in our P&L in fiscal 2020 and as we've re-segmented and changed some of [indiscernible] (00:34:30) and classifications. We've applied that historically, retroactively. So the like-for-like percentages of G&A relative to revenue will demonstrate in fiscal 2020 that improvement.

We're also expecting as you mentioned supply chain to continue to deliver. We've been very successful over the years through our increasing scale and through the relationships we have with our suppliers as well as through the work that we're doing on product innovation to optimize gross margin. We do expect that will continue to be a source of margin improvement. And then finally, I would highlight what we're continuing to do at the store level. Even as we continue to invest with or behind labor, behind partner labor and behind technology we're finding those opportunities to realize efficiencies and the way that we operate to create more capacity for those investments in ways that enable us to manage to that 17% to 18% in the near-term, while still having the potential to go beyond that depending on how we balance sales growth against those investments in any particular year.

John Glass
Analyst, Morgan Stanley & Co. LLC

Fantastic. Thanks very much for coming out this morning. We really appreciate your time and for those of you want to follow up on this conversation, we've got a break-out immediately following. So thanks.

Patrick J. Grismer

Executive Vice President & Chief Financial Officer, Starbucks Corp.

Thank you very much.