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Starbucks Corp. (SBUX)

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CORPORATE PARTICIPANTS

Laxman Narasimhan

Chief Executive Officer & Director, Starbucks Corp.

OTHER PARTICIPANTS

Brian Harbour

Analyst, Morgan Stanley & Co. LLC

MANAGEMENT DISCUSSION SECTION

Brian Harbour

Analyst, Morgan Stanley & Co. LLC

Thank you. Thank you, everyone. I'm Brian Harbour. I'm the Restaurant and Food Service Distribution Analyst at Morgan Stanley. First of all, the joint forum here. So, I just wanted to thank everyone for being here, it means a lot. And just a couple of stats. Sorry if this sounds like an earnings call, but since 2019, we have 30% more investors here, we have 30% more companies, 65% more meetings compared to our 2019 conference. So, thank you all for making it so successful. And thanks especially to the team behind the scenes to organize all of this.

And now I'm very excited – we're excited to have Starbucks here. The new CEO, relatively new CEO, Laxman Narasimhan.

Laxman Narasimhan

Chief Executive Officer & Director, Starbucks Corp.

Well, you've pronounced that really well.

Brian Harbour

Analyst, Morgan Stanley & Co. LLC

I had some coaching, so thank you. And Starbucks certainly needs no introduction. So, actually if you have any opening comments, I'll turn over to you.

Laxman Narasimhan

Chief Executive Officer & Director, Starbucks Corp.

Well, first of all, I don't see a drink and this is our holiday.

Brian Harbour

Analyst, Morgan Stanley & Co. LLC

Next year, we'll have Starbucks coffee.

Laxman Narasimhan

Chief Executive Officer & Director, Starbucks Corp.

Let's just over start that, doppio espresso macchiato, it doesn't fit inside me now. Well, first of all, thank you all for being here. Starbucks as a company is a very strong brand, we're focused on human connection. And I think the need for human connection is even more relevant today than it ever was. I've just come out last night, launching our values across our entire company. In fact, it was – it's been a nine-month process of us landing the mission, the promises and the values. And, I joined Starbucks because at the heart of it, it's a giving company.

If you look at our – if you just look at our promises, our promises say that for our partners, we bridge to a better future. For our customers, we uplift the everyday, for the farmers, we ensure the future of coffee for all, for the communities we contribute positively, for the environment at our best, we give more than we take. And what that leads to at the end of it is, for our shareholders it results in enduring long-term returns, for our shareholders.

I've worked in stores, I've worked in stores in many, many countries around the world and particularly as you see the environment right now, I've had an international career of over 30-years where, if you look across the public sector, the private sector and the social sector and it's clearly quite an intense environment out there [ph] and headwinds (00:02:59) and what you see there are actually quite large. And we as a company are a company that is a – we are against violence of any kind, everywhere and all the time. And we're clearly pro joy and pro belonging, which were two of the values, we talked about as a company. We talked about craft, coffee and what we bring, results, courage, belonging and joy. And I think it needs to be said at this moment in time because there's no question that what you see out there, the geopolitical challenges are large. There are clearly headwinds out there. And just as an example what you see in areas of conflict with our business in some of those places.

Additionally, what do you see as a context is and you've read this in the press and everywhere else and everything that's going on is, you're operating in an environment where the US consumer is slowing. And despite all those different headwinds, if you think about what we stood for and what we talked about, a month, a week or so ago about our strategy, which is the Triple Shot Reinvention with two pumps. It's an extremely relevant strategy for the long-term. So, it'll help us in the long-term to really realize, a large amount of value for our shareholders, for our partners, for our customers as well as for the communities in question.

QUESTION AND ANSWER SECTION

Brian Harbour

Analyst, Morgan Stanley & Co. LLC

Q

Okay, great. One thing I just wanted to address upfront, you created a new committee on your board. Could you maybe talk about the impetus for that and how we should think about that?

Laxman Narasimhan

Chief Executive Officer & Director, Starbucks Corp.

A

Well, first of all, I think as I've joined the company, governance is obviously front and center on our minds. And we think long and hard about it and the board, Mellody Hobson, our Chair; Jørgen Vig Knudstorp, who is the head of the nomination committee and I have been working very intensively on how we ensure that we make Starbucks and we continue to make Starbucks a paragon for governance going forward. And so, in this world, that we are in, there are a bunch of commitments that we've made, be it to the environment, be it to the partners and be it to the communities that we live and work in.

And if you look at what's coming with regard to the changes taking place in regulations, in places like Europe, for example, particularly on climate. So, if you look at the assessments that we've been doing internally on us as a company, we felt it was appropriate to actually put a committee together that would actually oversee what we do in this entire space of environment, partners, as well as of the community and the community impact that we have.

And so, in our meetings in July and even in September, we agreed that we would actually put this committee together, which we announced. And just some time ago, we have Beth Ford leading it. Beth as you know the CEO of Land O'Lakes and she comes – she's obviously a uniquely capable and qualified person. She provides the oversight for the community – for the committee and what she does along with a nomination committee and a chair, provides us the ability to ensure that we're living up to the commitments that we have made. And so, I feel good about it, actually and [ph] it's going (00:06:31) to continue to step-up in governance of the company.

Brian Harbour

Analyst, Morgan Stanley & Co. LLC

Q

Okay. What surprised you most when you joined Starbucks?

Laxman Narasimhan

Chief Executive Officer & Director, Starbucks Corp.

A

The amount of coffee knowledge people had. It intimidated me, actually, because it was a – it's very, very deep inside the culture of the company. But on a more sort of serious note, what surprised me most about the place was, actually how partner centered the company actually is, the strength of the brand and what it really meant. And I think, if I think a little bit about the commitment that we have made over time, the ability, the appeal for this brand globally is actually really quite large.

And things changed on Starbucks over the course of COVID. COVID was tough on the company. And I think as we came out of it, we recovered from it, it was clear that with the right level of investments and with a focus strategically as to where we would go, we would have the ability to truly capture those limitless potential. So, what surprised me in a very positive manner was what you have to work with, the strength of the partners, the strength

of the management team, the base on which the business is starting, the international presence. But even though we were international, we were frankly not fully tapped, let alone international, even in the US.

If I look at what's going on in the south or southeast and our businesses in many of these places, Tier 2, Tier 3 towns, the potential for this brand is actually really quite large. And so, I think that if I look at food, it's an opportunity, it's an attach business to beverage [ph] full play (00:08:09) you look at the [ph] merchandize in the (00:08:12) stores opportunity, if I look at Starbucks Reserve over time an opportunity. So, there's many things, the digital piece of the business which I know you – surely you want to talk about, it's really untapped, in terms of the full play that we have. So, I think there are several elements of this business that actually have a bigger play and that is at the heart of the Triple Shot Reinvention with the two pumps. Productivity, by the way, is the other one that I will touch on it.

Brian Harbour

Analyst, Morgan Stanley & Co. LLC

Don't worry, we'll get to it.

Q

Laxman Narasimhan

Chief Executive Officer & Director, Starbucks Corp.

Sure.

A

Brian Harbour

Analyst, Morgan Stanley & Co. LLC

One more general question I think, your US business did quite well in fiscal 2023. You're still driving traffic growth. What do you think is – what do you think is kind of behind that, right? Do you also think perhaps there's just less likelihood for people to trade down to at-home coffee? What do you think has continued to drive that strong performance?

Q

Laxman Narasimhan

Chief Executive Officer & Director, Starbucks Corp.

I think, first of all, if they do want at-home coffee, we are the number one brand there. So, we have presence there, with the business there. So, coffee clearly is there. I think if you look at the US business, what you now have is a business that through COVID has evolved enormously. I mean, it's got a digital footprint that is much larger than it was. There's a delivery business [ph] which doesn't exist (00:09:20) and I think we're just tapping surface, I think, if you just look at, the different occasions when our stores aren't open and the demand that we have and we know this through things that we've looked at and pilots that we run, there is in fact further potential, which we haven't fully tapped into.

A

If you look at the afternoon, we still have play there. But we now have a business that actually is digital, the mornings are obviously the heart of the business. The afternoon still a play, we still have geographical penetration in the US that could be large, but we have a strength with our loyals, with our people who own the app. We have 33 million people now and it's growing every year, but when we see frequency going up, we have a large number of people we have access to that are not in the 33 million that we haven't fully tapped into.

But at the core of it is innovation, product, what is it that people coming to the store for? Customization at the heart of who we are. The experience that they get in the stores and what that's about. And if you take all that into account and what the brand stands for, the ability for us to deliver consistent quality mostly and I realized that sometimes it doesn't fully happen. Our ability to do all of that, makes us very distinctive in this world. And so,

that's what I believe is actually going on in the US business and contributed to the kind of performance that we saw last year, where if you ignore the effects of foreign currency last year, the FY 2023, we grew at 14%.

Brian Harbour

Analyst, Morgan Stanley & Co. LLC

Q

Yes. Let's talk about product innovation a bit. I think – one thing you mentioned quite a bit last month was PM daypart opportunity. So, maybe, talk about what kind of opportunity you see there? What we should look forward to in the next couple of years in the PM daypart?

Laxman Narasimhan

Chief Executive Officer & Director, Starbucks Corp.

A

So, if you just look at our business and on the beverage side, it is – it has shifted heavily to cold. But what we're seeing in the PM daypart [ph] is that there's (00:11:21) even more potential. And it's going to be innovation that is going to be highly targeted that we bring in, we already have the footprint. There'll be a lot of people who say, we're targeting the PM footprint, but we actually have stores and we have the ability and the capacity to be able to do it, including the innovation.

So, on the beverage side, it's really quite large, possibilities are real. But in addition to that, we have a food attach opportunity. I mean, there's breakfast business which I think we went into reluctantly many years ago, right? All of a sudden, it's a huge business and [ph] we're selling a lot (00:11:54) and what we see from our customers is, they would like all-day breakfast, they would like all-day snacking, they would like to find a way to attach, our food to the beverages they buy. And particularly as you think of drive-thrus and you look at what's going on with mobile order pay, it's much easier the customer attach what we have. So, I think there's a real play in the afternoon that we haven't fully tapped into yet and that's going to require innovation, it's going to require digital, it's going to require customization, it's going to require attach. And we have the capacity and the ability to do it, it's an area for us, that'll be a big growth opportunity for us going forward too.

Brian Harbour

Analyst, Morgan Stanley & Co. LLC

Q

Do you have a different view of food than some of your predecessors? Because I think that's kind of ebbed and flowed over the year at Starbucks. What do you think about kind of the food opportunity?

Laxman Narasimhan

Chief Executive Officer & Director, Starbucks Corp.

A

I think, first of all. I think it's different, I think the customer has changed. As you think a little bit about the customer going through mobile order pay or through drive-thrus, we're seeing attach rates that are quite high. I think in the US it's 205 that are attaching, but it's not 305, which again, would just fundamentally change, just the size of that business. I mean it's already a \$6 billion dollar business growing enormously, right? And the opportunity though, is for us in particular, as you bring in tools like, the warming ovens that are more evolved and what we do with Siren System and how we think about, things that we bring in.

I think you have the ability to actually create an experience there too, that's also more elevated. So, the innovation coupled with what we're bringing in, in terms of the physical footprint, coupled with what we have in digital as well as drive-thrus and delivery that is actually adding to the nature of this business. And it'll always be an attach business for us, we're always beverage first.

Brian Harbour

Analyst, Morgan Stanley & Co. LLC

Q

I was actually somewhat surprised by the stat that I think you gave 85% of beverage sales are core products, 15% are seasonal/new. Is that always been the case? Do you think that will change over time?

Laxman Narasimhan

Chief Executive Officer & Director, Starbucks Corp.

A

Yeah, I think it's a question of how you think about what core is, right.

Brian Harbour

Analyst, Morgan Stanley & Co. LLC

Q

Yeah.

Laxman Narasimhan

Chief Executive Officer & Director, Starbucks Corp.

A

So, what is interesting about this, that you take a core espresso and then you have things that you're innovating, particularly with customization. Customization, business is really quite large. So, think of it as a landscape on which you're painting or a canvas on which you're painting. And I think customization keeps our core at 85%, and obviously the strength of core is really quite important. And what we do with the others, the other 15% is we're bringing people in with things that are exciting. And so, you will see us continue to do that.

But customization, just today we've just launched four new winter foams, cold foams that you can use for customization, you will see more there in the way that we help people have core but also bring a twist to the core. And then of course, you have new products and you have LTOs and so on, that we bring people in. So, it has been so – but if you look at hot coffee, which is again part of our core. The fact that we're rolling out the Clover Vertica is going to mean a much higher quality coffee that is delivered on demand and that's going to make the core hot coffee better as well, it's still an opportunity for us.

Brian Harbour

Analyst, Morgan Stanley & Co. LLC

Q

Right. Yeah, makes sense. Maybe let's talk about digital. I mean clearly you have a very impressive digital business, right? I go into my local Starbucks and it's clearly quite highly used, right? [ph] what and you want (00:15:25) double it? So, what's going to drive that, what's key to that, do you think? You talked about some of these partnerships, what else to bring?

Laxman Narasimhan

Chief Executive Officer & Director, Starbucks Corp.

A

Look, we're on a track. Even if you just look at the current run rates, if we just sustain that, you get very close to that. So, we're starting from a great base. Secondly, we're actually really changing the metabolic rate inside the company around digital and digital innovation. We're into literally 30, 60, 90-day releases. The team has meetings with me in every six weeks and we look back and say, what do we say? We've achieved 30 days, 60 days, 90 days where we're at now? What's coming in the pipeline, 30, 60, 90 and so, there's a metabolic rate. And the way the team is working together, that is actually much faster, in terms of the innovation that's coming. Some of the stuff you will see and some of the stuff is actually behind the scenes, in terms of making a much better recommendation. If we're out of stock or something as an example.

What's going to drive it is. First of all, just the – we have a huge universe that we're already in touch, I think in the Investor Day we talked about, if you take globally, it's 75 million members of the Starbucks Rewards. We have some kind of a digital relationship with over 300 million people [ph] so the base system (00:16:48) then it's a question of how you ensure that you make offers that make them attractive, attractive to come in, how you ensure that you deliver conveniently, it's the business model and how you evolve it. Mobile order pickup as an example, it then get into the level of customization that you're bringing in and then potentially what you do with loyalty.

Brian Harbour

Analyst, Morgan Stanley & Co. LLC

Q

Right.

Laxman Narasimhan

Chief Executive Officer & Director, Starbucks Corp.

A

Particularly with Starbucks Rewards. And I think this is where this partnership fits in. We've already got a partnership with Delta and you see what happens. If you look at the week of Thanksgiving and the travel day [ph] that existed then (00:17:21) the partnership with Delta obviously meant that there were specific offers to people who were traveling that week as one example. We're going to announce two more, one with a hospitality company and the other with another financial institution that will actually give us further connectivity in base and actually increases value to our loyals, in terms of the benefit that we provide them.

There are digital businesses that we're incubating even on top of all of this, that will actually help us further scale what we do there outside the store, different profit pools that are available. I won't get into all the details on that, but all this actually tells you that there's a digital opportunity that is actually quite significant, it drives business into the stores, it makes people shop there more frequently, but it also gives us the ability to add more to what they do, that's at the heart of what we're doing.

Now in order to do that we're – and you heard in the Investor Forum that we had, we're working on technology and how we architect that. Clearly the partnerships with some of the leading providers in the space, we mentioned the partnership with Microsoft and GenAI, the work we're doing with Apple products. On how we ensure we bring that into the partner experience as well as the work we're doing with Apple on – sorry with Amazon on payment. All these things put together actually tells you this is a brand that people want to partner with and actually bring to life in a way that we can actually fully capture the digital opportunity as a company.

Brian Harbour

Analyst, Morgan Stanley & Co. LLC

Q

And I think some of that also plays into personalization. So, how do some of those partnerships and what you're doing today kind of help with personalization specifically?

Laxman Narasimhan

Chief Executive Officer & Director, Starbucks Corp.

A

First of all, the business is set-up for customization, which is actually at the heart of personalization in a physical sense. And that's going to get even more amplified as we think a little bit about, what is going on with regard to – with GenAI coming in and how we sort of make all that work. We're still in journey of how we learn more and more about individual customers. I mean, there's still work to be done. And I think what it does for us is, we clearly had – we built the Deep Brew, which is our platform, artificial intelligence and machine learning platform, which we built for five years [ph] quite forward if you think (00:19:45) about when it was done. And now, as you see this tech change, the architectural change that's coming, the work for us now is, how do we then take that across all the

data that we have, our partners as well as the – our customers and how we put together pictures that actually give us even more and what's going on with the individual customers. So, that's the personalization journey, we'll go into, which actually helps you come up with products that you can customize for yourself and make it easier to make, offers that actually will make you even more loyal and you realize more value from Starbucks Rewards, that's the journey we're on.

Brian Harbour

Analyst, Morgan Stanley & Co. LLC

Q

Okay, makes sense. Maybe let's talk a little bit about, store operations and efficiency. What do you think has actually been most impactful so far in the past year? And then what you think will be most important in 2014?

Laxman Narasimhan

Chief Executive Officer & Director, Starbucks Corp.

A

I think, if you look at the work in Reinvention, which makes complete sense to me, when I came, actually when I joined, we went through the entire program and the efforts all made sense to me. And I think you see that in the results from last year just around the progress we've made with just Reinvention. We've invested something like \$9 billion over the last three years with a combination of things that we put into stores as well as a partner experience.

Almost a third of that is into the partners themselves, which is about 20% of the profit that we generate has actually gone into that, which has been a very good set of investments that we've made. And I think what you've seen there is, we have been able to put in to the stores some equipment that has been very helpful, portable cold foam blender is an example, help us with the customization of some of the foams and we did it just before the summer holiday, so it actually played itself all the way through.

What's coming though is – what has been being built is, if you look at waste, we attacked waste quite systematically, there's \$90 million of waste savings [ph] that we delivered (00:21:42) just last year, there's more to come with that. But that was very powerful and good. But really the big thing was what we did with staffing and scheduling. It was very clear to me, working in stores that we could do better there, how we match demand with supply, how we get more personalized in terms of what the partners want, we're not fully there yet. But if you just look at what we've been able to do, if I go back to 2020 to where we are now, right? Essentially the take home compensation has gone up for the partners by 50%. And we think by 2025 it's going – in effect from 2020 be double [ph] I always have (00:22:23) very big part of this.

Brian Harbour

Analyst, Morgan Stanley & Co. LLC

Q

Right.

Laxman Narasimhan

Chief Executive Officer & Director, Starbucks Corp.

A

And the way we work it is actually quite important. There's a lot more stability, operational stability in the stores [indiscernible] (00:22:31) it's almost up by a year, which is a lot for us. And so, staffing and scheduling has been a big area of work. We're not fully there yet and there's more to come. And what we are doing is, I mean, the level of math, the level of technology that's going into it, I mean we have a large number of shifts around our network, even people who want to work for 20 hours and someone wants to work 30. So, we actually – it's a very complex set of teams working really hard and how we unpack all that. So there's more to come.

Looking ahead, actually, we should look above the store. The \$3 billion productivity program that we touched on, 70% of it is outside the store. I ran the supply chain for six months along with running the stores. Rachel gives me no credit for that. I just wanted to point out.

But by the way, but I was actually running the supply chain and by the way attach rates went up and then stock went up, Rachel just so you know. In any event and [ph] we always have a (00:23:36) great talent in there. But why did I do that? Part of it was to really elevate that in the company, if I think about innovation and what we can do, lot of great ideas in what we do with tech and innovation, product has to be available. And so, [ph] what we (00:23:50) can buy better, we can flow better, we can store better. And there's really work going in there. And what is interesting in all that is we've actually put in place a muscle in the company on productivity that is in fact the engine of what's going to keep driving this going forward. And is at the base of what we call progressive margin expansion over time.

So today there's a language inside the company around where we're getting ideas? Who's managing the pipeline? How do we go? There's a review every 30 days on it, to say, how are we making progress versus not? And frankly, I feel very good about the traction and the progress we're getting.

Brian Harbour

Analyst, Morgan Stanley & Co. LLC

Q

If I look at the store with all the new equipment that you've talked about, are you running that with fewer labor hours or are you able to quantify that at all?

Laxman Narasimhan

Chief Executive Officer & Director, Starbucks Corp.

A

I don't think the focus is to run it with fewer labor hours. The focus is to optimize the labor hours to meet greater demand. So, it's a throughput question. I mean, there's no question that I know and we know this, that if I look at bulk rates, what we have, what we call [ph] couch board (00:24:57) people sitting at home, in a drive-through, they're coming into the store, looking at the line and say, you know what, I'm not going to do this, we clearly have that and we're working to make it better.

Brian Harbour

Analyst, Morgan Stanley & Co. LLC

Q

The vast majority of stores would you say is throughput still a pretty widespread limitation in your view?

Laxman Narasimhan

Chief Executive Officer & Director, Starbucks Corp.

A

I don't think it's all the stores, but I think it's in many stores.

Brian Harbour

Analyst, Morgan Stanley & Co. LLC

Q

Okay, makes sense. I'm just going [ph] to start about (00:25:23) this is maybe a dumb question. Why is the third place model still important, right? Given you're mostly an off-premise business today, right?

Laxman Narasimhan

Chief Executive Officer & Director, Starbucks Corp.

A

Well, just think of it, right? I mean, let's look at what's going on today, right? There are people who are looking to find ways to connect and they do come into our stores by the way, they do come into our stores. And despite all the misinformation and despite all the overhyping that is going on, people still come in. They want a place where they can have a warm connection, a conversation, frankly get product and leave. I understand fully your point around saying there are several people who are – who have moved their behavior into more drive-thrus or online.

But the third place actually has quite a relevance, both physically but increasingly also digitally. And I keep using the story of my time and working in the stores in Beverly in the south of Chicago, with a woman who was in the drive-thru at 7 in the morning on Monday and I remember opening the window to deliver the customized hot coffee that she had wanted and the window rolled down and the woman was [ph] half made up and had the makeup (00:26:30) there. And she looked at me with a combination of anxiety, but also relief to see what she was getting. And I just said, I hope you had a great weekend and I hope you have a great day at work, that moment matter because I was probably the first person she was talking to all weekend.

And so, I think we cannot really take away from this idea that there is a point of human connection and that's what this brand is about. That's why the values we have, the mission we have, the purpose of the brand is big in this, but digitally we're able to do it too, what we do with mobile order pay and others [ph] but messages that you get (00:27:07) and so on. And we haven't fully tapped it out yet fully. So, I think third place is a broader definition. I think, we used to talk about the fact that people go to Starbucks to connect with others. The reality is, people rely on Starbucks to connect with themselves as much as and through that connect with others. And I think that's a broader expansion of what our mission is. And with that, you see the Starbucks at-home and the moment of Zen you have at-home, it's the moment you have at the drive-thru, what you do later on at work with others as well. So, I think it's a broader definition of who we are, but classic definition of third place, it's a box where I go to meet someone, it's frankly not relevant anymore in this context.

Brian Harbour

Analyst, Morgan Stanley & Co. LLC

Q

Yeah. Okay, makes sense. I do want to talk about the cost and margin side a little bit. The margins as you said, historical margins [ph] would be in play (00:27:55) over time, right? And I'm not going to put words in your mouth, but if I were to say, 5% same-store sales roughly, maybe 3% to 5% cost inflation over time. Do you kind of get there naturally and you would say, okay, some of the \$3 billion cost program that you've talked about adds to that, what other pieces would I think about there?

Laxman Narasimhan

Chief Executive Officer & Director, Starbucks Corp.

A

I think what we talked about is progressive margin expansion, which comes from a combination of sales leverage, which is all the math that you have there, it comes from the productivity programs that we have, which are broad. They are above the store as well as in the store. And also, the further enhancements that we can think of the area of revenue management that actually help us overall with the progressive margin expansion. So, I think – as you know, we don't set a margin target or a time, but in the long-term, I think, you can clearly see, how we get back to the levels that you would talk about.

Brian Harbour

Analyst, Morgan Stanley & Co. LLC

Q

Yeah. You sort of mentioned this, behind the \$3 billion program, part of it waste, part of it supply chain. I mean, what are the other major initiatives, we should be thinking about within that program?

Laxman Narasimhan

Chief Executive Officer & Director, Starbucks Corp.

In the productivity program?

A

Brian Harbour

Analyst, Morgan Stanley & Co. LLC

Yeah, in the \$3 billion cost program?

Q

Laxman Narasimhan

Chief Executive Officer & Director, Starbucks Corp.

Yeah. So as you said, 70% [ph] is about the (00:29:13) store that actually looks at everything from procurement to supply to the services that we provide and how we optimize all of it. And there's clearly more in the store, including waste, including looking at how we get much better at, bringing in the right equipment that helps us, helps our partners, do things more efficiently in the store. So, it's literally a comprehensive program. Obviously, you get sales and sales leverage above that, including the G&A, which is, we did make an investment in, in order to launch the program and as sales keep growing, you're going to see that number come down over time.

A

Brian Harbour

Analyst, Morgan Stanley & Co. LLC

Right, okay. Do some of your ESG initiatives help there, right? Like I think you're starting to push more reusable cups. I mean, does any of that make a difference on the margin side, for example?

Q

Laxman Narasimhan

Chief Executive Officer & Director, Starbucks Corp.

We are embedding a lot of the sustainability ideas into how we do this. I mean, almost every single touch point that we have in the productivity program, there is a question around how do you ensure the sustainability is built into what we do? So, it will have an impact there.

A

Brian Harbour

Analyst, Morgan Stanley & Co. LLC

Right.

Q

Laxman Narasimhan

Chief Executive Officer & Director, Starbucks Corp.

Waste reduction, for example...

A

Brian Harbour

Analyst, Morgan Stanley & Co. LLC

... yeah.

Q

Laxman Narasimhan

Chief Executive Officer & Director, Starbucks Corp.

... is a big way for that to happen.

A

Brian Harbour

Analyst, Morgan Stanley & Co. LLC

Q

Okay, okay. I do want to talk about China a little bit. I think we've all got the message that the business is very different than four years ago. And certainly there's drastically different number of stores there.

Laxman Narasimhan

Chief Executive Officer & Director, Starbucks Corp.

A

Yeah.

Brian Harbour

Analyst, Morgan Stanley & Co. LLC

Q

Today it is lower volume, it is lower margin. You're still kind of in a recovery phase there. What – so we know what your store expansion target is, what else do you think is really going to drive China on a same-store basis, perhaps over the next several years?

Laxman Narasimhan

Chief Executive Officer & Director, Starbucks Corp.

A

Well, firstly, it is a different business where it was pre-COVID. We went to China in 1999 with the idea of actually working to create this specialty coffee industry and a tea drinking country, massive tea drinking country. I heard people talk about how the next China is China. We actually subscribe to that view. And so, if you look at, where we have gotten after 24 years, we've gotten them to 12 cups per capita. Japan is at 280, which has a big history of coffee, drinking, over the years and the US is at 380.

So, we're still in early days, if you look at where we are, you look at our store count and of course, the stores there are different from here in so many ways. 65% of our stores today were not there pre-COVID. So, clearly it's a different network, we have a digital business that we didn't have before. We have a delivery business that we didn't have before, we have that now. And so it is, in fact a very different business. Now we have a premium brand actually we have two premium brands, we have Starbucks and we have Starbucks Reserve, both brands in China and both extremely well regarded as sort of premium propositions in China.

And, we haven't fully penetrated wherever you could be, which we're now in 800 county cities out of 3,000, Shanghai we have 1,150 stores, I've been to Shanghai. There are many parts of Shanghai we're not in yet. So, there's even penetration in Shanghai, let alone Beijing and the other cities, lower down in the place that we're in. Now the fact is, you've read all the press on China, about what's going on with the economy and how it is. And we see it, too. We see clearly that the recovery that we're seeing is perhaps half the rate of what you would expect it to be, given what you saw in the fourth quarter last year.

So, it's recovering and normalizing, but at rate slower than what you would expect. But the long-term is very clear. Once you see China work through its challenges, I think you will see in the long-term it's a business that is very strong, it's a highly competitive market, do not get me wrong. It is more promotional now than it's ever been, you see more discounting and all of it. But at the end of the day, we deliver a premium experience [ph] and neither the market hasn't teared (00:33:09) yet like it is here.

Brian Harbour

Analyst, Morgan Stanley & Co. LLC

Q

Right. Yeah. I mean, is it fair to say that in the near-term that's still sort of a choppy market?

Laxman Narasimhan

Chief Executive Officer & Director, Starbucks Corp.

A

Yes, it'll be choppy and the recovery will be choppy, but it is normalizing at half the pace than what you would think it would.

Brian Harbour

Analyst, Morgan Stanley & Co. LLC

Q

Okay, okay. Understood, international outside of China, I think you've focused more on that in your time so far. What's – in your view, what was not appreciated there before? What are some of the markets that you're more excited about?

Laxman Narasimhan

Chief Executive Officer & Director, Starbucks Corp.

A

I think, what is underappreciated first of all, is that actually it is substantial. I mean, a lot of our business in the US, but I think, we've talked about the fact that International and China are kind of in the same level, in terms of the contributions over time, it wasn't so before COVID, but it is so now. I think what is underappreciated was the unit economics in many of these markets, they're actually very strong. Now we have a different business model, so it's appreciated in a different way. But the unit economics were underappreciated. And I fully recognize that we've got all these things going on and international geopolitics and some of the conflict countries affected at this point in time. But if you look at the long-term, the brand is very strong, the unit economics are really strong.

The partner and the culture that's been built with our geographic partners who we've had for years is actually very strong. And the headroom we have in terms of what we could get to is extremely strong and the headroom is large pretty much across the board. Latin America, continental Europe, where maybe it's still early [ph] I'm going to suffice to (00:37:48) say this, but we still are not really fully where we need to be in continental Europe. And then you get into of course, Southeast Asia, where there's a big growth play.

The coffee culture grows there, India where the coffee culture is growing opportunity there too. And then you look at the Middle East and Africa, notwithstanding the near-term but long-term there's real potential in play there too. So, I think what needs to be appreciated more is the fact that it is in fact the third leg of the stool for us in many ways. And we haven't fully – we haven't fully tapped into that yet, there's still more to play.

Brian Harbour

Analyst, Morgan Stanley & Co. LLC

Q

Okay.

Laxman Narasimhan

Chief Executive Officer & Director, Starbucks Corp.

A

Digital is a very big part of this.

Brian Harbour

Analyst, Morgan Stanley & Co. LLC

Q

Yes. It seems like it's quite early relative to some other markets.

Laxman Narasimhan

Chief Executive Officer & Director, Starbucks Corp.

A

Yeah. And the platform we're building, the Starbucks Digital Solutions will help us essentially build this global network across all our different businesses globally.

Brian Harbour

Analyst, Morgan Stanley & Co. LLC

Q

Okay. Sounds good. Before we finish up, I was going to do my lightning round question.

Laxman Narasimhan

Chief Executive Officer & Director, Starbucks Corp.

A

Yeah.

Brian Harbour

Analyst, Morgan Stanley & Co. LLC

Q

We've asked to everyone here. Demand backdrop for the year ahead relative to recent trends accelerate [ph] hold (00:35:49) decelerate?

Laxman Narasimhan

Chief Executive Officer & Director, Starbucks Corp.

A

Last year we grew at 14% without forex. I think the expectations we set in a month and a half ago were at the lower end of 10% to 12% if we ignore currency. So that will be slower than last year and I think it's more back-end loaded, in terms of the overall – but a strong growth in the front end.

Brian Harbour

Analyst, Morgan Stanley & Co. LLC

Q

Makes sense. And then margins, we kind of know the answer to this, but up down...

Laxman Narasimhan

Chief Executive Officer & Director, Starbucks Corp.

A

... progressively improving.

Brian Harbour

Analyst, Morgan Stanley & Co. LLC

Q

Yeah. And then capital allocation, prioritization between CapEx, buybacks, dividends, debt pay down, any change in relative importance of those?

Laxman Narasimhan

Chief Executive Officer & Director, Starbucks Corp.

A

We will invest in the business. OpEx, CapEx [ph] as the needs are (00:36:31) second, for a growth company, in a growth stock, as you might call it, we've actually have a history over the years of maintaining a 50% dividend payout ratio. We intend to sustain that. And then the question of what do you do with the rest of the money? I think it depends a bit on cost of capital and what's really going on in the world out there as to, whether [ph] we bar to buyback (00:36:55) stock or whether we pay down debt, that's a calculation we always go. Just so, you know stock buybacks at a very small portion of the EPS growth expectations that we set, it looks like less than 1% or 1% of that 15-plus-percent that we set for the long-term.

Brian Harbour

Analyst, Morgan Stanley & Co. LLC

Okay, great. We'll end it there. And very much appreciate it.

Laxman Narasimhan

Chief Executive Officer & Director, Starbucks Corp.

Thank you. And you didn't tell me what your drink is?

Brian Harbour

Analyst, Morgan Stanley & Co. LLC

My favorite drink is, I like the Iced Shaken Espresso.

Laxman Narasimhan

Chief Executive Officer & Director, Starbucks Corp.

Iced Shaken Espresso.

Brian Harbour

Analyst, Morgan Stanley & Co. LLC

Yeah. With oatmilk.

Laxman Narasimhan

Chief Executive Officer & Director, Starbucks Corp.

Okay, 35 cal. The oatmilk is a little higher, but that's okay. I think you can do with it. Thank you so much.

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