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Starbucks Corp. (SBUX)

Q4 2019 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon. My name is Hector, and I will be your conference operator today. I would like to welcome everyone to Starbucks Coffee Company's Fourth Quarter and Fiscal Year 2019 Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. [Operator Instructions]

I will now turn the call over to Durga Doraisamy, Vice President of Investor Relations. Ms. Doraisamy, you may now begin your conference.

Durga Doraisamy

Vice President-Investor Relations, Starbucks Corp.

Good afternoon, everyone, and thank you for joining us today to discuss our fourth quarter and fiscal year 2019 results. Today's discussion will be led by Kevin Johnson, President and CEO; and Pat Grismer, CFO. And for Q&A, we will be joined by Roz Brewer, Chief Operating Officer and Group President Americas; John Culver, Group President, International, Channel Development and Global Coffee & Tea.

This conference call will include forward-looking statements, which are subject to various risks and uncertainties that could cause our actual results to differ materially from these statements. Any such statements should be considered in conjunction with cautionary statements in our earnings release and risk factor discussions in our filings with the SEC, including our last Annual Report on Form 10-K.

Starbucks assumes no obligation to update any of these forward-looking statements or information. GAAP results in fiscal 2019 include several items related to strategic actions, including restructuring and impairment charges, transaction and integration costs and other items. These items are excluded from our non-GAAP results. Please refer to our website at investor.starbucks.com to find the reconciliation of certain non-GAAP financial measures referenced in today's call with their corresponding GAAP measures.

Additionally, as previously announced, restated GAAP and non-GAAP quarterly financial information for fiscal 2018 and through Q3 fiscal 2019 reflecting our realigned operating segment reporting structure and reclassification of certain costs can also be accessed on our Investor Relations website.

I would like to note that during today's call, we will be providing select presentation materials which can be accessed via the webcast of this call and on our IR website at the conclusion of the call.

An archive of the webcast will be available on our website through Thursday, November 28, 2019. Finally, for your calendar planning purposes, please note that our first quarter fiscal year 2020 earnings conference call has been tentatively scheduled for Tuesday, January 28, 2020.

I will now turn the call over to Kevin.

Kevin Johnson

President, Chief Executive Officer & Director, Starbucks Corp.

Well, good afternoon, and welcome. As part of my ongoing visits to Starbucks stores around the world, I'm joining today's call from Tokyo. On this particular trip, John Culver and I are joined by Nestle's senior executives to

discuss our collective strategy for growth and review the great progress our teams have made implementing Global Coffee Alliance. Today, I'm pleased to share that Starbucks delivered strong operating results again in Q4.

Capping off a transformative year for the company as we continue to execute our Growth at Scale agenda with focus and discipline. Pat will review our financial results in more detail later in the call, but I'll start by sharing performance highlights for the quarter and the year, as well as some key actions we've taken and important investments we've made to enable predictable, sustainable growth, while delivering value for all our stakeholders as we build an enduring company at Starbucks.

In the fourth quarter, Starbucks delivered revenue growth of 10%, excluding the 3% impact of Streamline activities and foreign exchange, led by global comp sales growth of 5%, and net store growth of 7% year-over-year. These strong operating results yielded non-GAAP EPS of \$0.70 for the quarter, up 13% from last year.

In the US, we posted comp sales growth of 6% in Q4, including comp transaction growth of 3%. That's a two-year sales comp of 10% for Q4, a sequential improvement over our very strong results in Q3 and our best performance in the US in over two years.

In China, we posted 5% comp sales growth in Q4 including comp transaction growth of 2%. That's a two-year sales comp of 6% for Q4, demonstrating continued positive momentum in our fastest growing business where we increased our store base by 17% over the prior year.

For the fiscal year, Starbucks delivered record results in both total net revenues and non-GAAP EPS. Total net revenues were \$26.5 billion, up 10% over the prior year when adjusted for Streamline activities and foreign exchange. This included 5% global comp sales growth for the year and over 1,900 net new stores globally, yielding a record non-GAAP EPS of \$2.83 for fiscal year 2019, up 17% versus prior year.

With more than 31,000 stores in 82 markets, welcoming over 100 million customer occasions each week and enabling over 1 billion digital customer occasions per year, Starbucks is a part of our customers' every day routines around the world and I applaud the 400,000 green apron partners who deliver a premium Starbucks experience to every customer they serve. Because of our partners, we are achieving even higher levels of customer loyalty and brand preference.

Now let me highlight some of the key initiatives and investments that drove our strong growth in fiscal 2019 and have laid the groundwork for what we expect will be another year of strong operating performance in fiscal 2020. In keeping with our Growth at Scale agenda, I will talk about how we're accelerating growth in the US and China; how we're extending the reach of our brand through the Global Coffee Alliance with Nestlé and how we've increased stakeholder returns.

I'm very proud of the progress the team has made against our three focused initiatives to accelerate growth in our US business: Enhancing the in-store experience, delivering relevant beverage innovation and driving digital relationships. We have strong evidence that our approach is working as demonstrated by the fact that we are seeing traffic growth across all dayparts and we intend to build on this momentum in the year ahead. We continue to see a strong correlation between Starbucks partner engagement and customer connection which leads to increased customer frequency. This reinforces our belief that the Starbucks Experience delivered by our partners is a key competitive advantage, and therefore, we are making targeted investments to elevate the partner experience with clear evidence that this, in turn, elevates the customer experience and drives growth.

Throughout fiscal 2019 in the US, we invested in our partners by allocating additional store labor, increasing store-level training and simplifying in-store tasks, often with new technology. For example, we introduced a new staffing and scheduling system to optimize labor allocations based on partner preferences and predictive analytics. These investments in our partners collectively elevated customer connections, as evidenced by an all-time-high in customer connection scores in Q4. And we will build on this momentum with incremental partner investments in fiscal year 2020. We also continued to invest in beverage innovation, and I'm pleased to say that beverages contributed 5 points of our US comp sales growth in the fourth quarter, led by the strength of our cold beverage platform.

We completed our rollout of Nitro Cold Brew across company-operated stores in the US this summer and introduced new cold pumpkin beverage offering, the Pumpkin Cream Cold Brew. And we're very encouraged by its reception. We expect this momentum to continue as we move into the favorable holiday season and we look forward to sharing more details with you in the weeks ahead.

And finally, we've continued to pursue new opportunities to expand digital customer relationships, investing to meet customers' increasing desire for convenience and personalized offers. Supported by the successful launch of multi-tier redemption in early Q3, we saw US Starbucks Rewards grow to 17.6 million active members at the end of Q4, a year-over-year increase of 15%. This is an important growth driver, because we know from experience that when customers join Starbucks Rewards, their spend level with Starbucks increases meaningfully.

On our last earnings call, I outlined the important strategic role that our digital flywheel plays in growing digital customer relationships. Clearly, that strategy is working.

I want to highlight another very important element of our digital strategy, artificial intelligence. Over this past year, we have been dialing up our in-house capabilities and investments in AI with an initiative we call [ph] Deep Brew. Deep Brew (10:36) will increasingly power our personalization engine, optimize store labor allocations and drive inventory management in our stores. We plan to leverage Deep Brew in ways that free up our partners so that they can spend more time connecting with customers. Deep Brew is a key differentiator for the future, and as we continue our quest to build world class AI capabilities to better support partners.

Moving on to how we've accelerated growth in China. Looking back over this past year, I'm very pleased with the progress we've made to capitalize on one of the world's most compelling growth opportunities led by strong store development, expanded digital customer engagement, and category-leading innovation. Store development continues to be our number one driver of growth in China. We opened over 600 net new stores in fiscal 2019, and crossed the 4,000-store mark while maintaining best-in-class new store returns. As we expand our store footprint, we have also been investing in innovative retail formats, including our Starbucks Now store in Beijing that opened in July, a unique, express retail experience that seamlessly integrates physical and digital touch points to enhance the Mobile Order & Pay and the Starbucks Delivers' customer experience.

We are seeing encouraging early results from this new format, and in China, we plan to open new Starbucks Now stores in top tier cities in fiscal 2020, leveraging this new store format to complement the third place store formats and increase market penetration.

As we've expanded our physical presence in China, we've also made significant strides expanding our digital presence in this fast-growing market. The Starbucks Rewards program in China, which we upgraded in December 2018, continues to rapidly drive new membership. At the end of Q4, active members reached 10 million, up 45% over the prior year. To support this growth, we've upleveled our Tmall flagship store in September to offer our

Starbucks Rewards members exclusive products and a tailor-made gift experience. And we enabled members to earn stars from online shopping. We recently celebrated the one-year anniversary of our China digital partnership with Alibaba, and I'm pleased to share that we surpassed our goal of expanding Starbucks Delivers to 3,000 stores in 100 cities by the end of the fiscal year.

This propelled mobile order sales mix in China to 10% in the fourth quarter, with 7 points coming from Starbucks Delivers and 3 points from our recently-launched mobile order for pickup. In the fourth quarter, we also ushered in a new era of digital customer engagement in China with the launch of voice ordering and delivery via Tmall Genie, as we continue to enhance the customer experience around mobile ordering.

These elevated digital experiences are key drivers of accelerated growth in Starbucks Rewards membership in China, and provides significant momentum for us to introduce further innovations in fiscal year 2020, as we work to constantly elevate the customer experience and reward loyalty.

Moving on to the Global Coffee Alliance, just one year after announcing this alliance with Nestle, we have launched three new coffee platforms in over 30 new markets. Starbucks by Nespresso, Starbucks by Dolce Gusto and Starbucks Roast and Ground coffees. We did this in record time and ahead of schedule.

In addition to the coffee platforms, we also launched a new product category, Starbucks Creamer's in North America in Q4. We entered China's at-home and food service segments through the alliance allowing Chinese consumers to enjoy some of their favorite Starbucks coffees in the comfort of their home. This partnership has enabled us to accelerate the global reach of the Starbucks brand in key markets. And looking ahead, we plan to be in 50 global markets in the first half of 2020.

Moving on to returns to one of our key stakeholder groups, our shareholders. In the fourth quarter, we returned nearly \$3 billion to shareholders through a combination of share repurchases and dividends, bringing our full year shareholder capital returns to \$12 billion. Including what we returned in fiscal year 2018, we've now returned approximately \$21 billion to shareholders, well on our way to meeting our three-year commitment of \$25 billion by the end of fiscal year 2020. And I'm pleased to share that our board has approved a 14% dividend increase this quarter, making the 10th consecutive year that we've increased our dividend by a double-digit percentage. Our Growth at Scale model combined with our strong balance sheet, positioned Starbucks to have the financial flexibility to both invest in our growth and reward our shareholders.

In closing, our fiscal year 2019 performance gives us confidence that our Growth at Scale agenda is helping unlock the full potential of the Starbucks brand. With great intentionality, we've invested in our partners, in technology and in our stores, to drive long-term growth. And we have made significant progress to streamline our company, through organizational restructuring and through the licensing of some international markets, enabling us to bring even more focus and discipline to the core of our business. This has helped us to accelerate the pace of innovation at Starbucks, both at the support center and in the field, to deliver relevant, meaningful and inspiring experiences for our partners and our customers. And with the plans that we've developed for fiscal year 2020 including continued investment, we are excited about our ability to sustain this growth in the years ahead.

Reflecting back on the historic Starbucks leadership experience we hosted in Chicago last month, it is my strong belief that the store manager plays a pivotal role in the growth and success of our company. That is why we've convened 12,000 store managers and field leaders from the U.S. and Canada to reflect on and celebrate our mission and values, while recommitting to the shared belief that by better serving our partners, we enable them to stand shoulder to shoulder and create best moments for our customers. This is at the center of who we are as a company and will remain a guiding light as we go forward.

The Chicago Leadership Experience was an important milestone in our journey. And we will be back in Chicago again next month for another key milestone, the opening of our sixth Starbucks Reserve Roastery. This will be the largest Starbucks store in the world, a beautifully-designed iconic store on Michigan Avenue. And I can't wait to celebrate this opening with our partners and customers, and we hope to see many of you there soon.

With that, I'll turn over the call to Pat and look forward to taking your questions later in the call. Pat?

Patrick J. Grismer

Chief Financial Officer & Executive Vice President, Starbucks Corp.

Thank you, Kevin, and good afternoon, everyone. There are three key points that I want to emphasize today. First, fiscal 2019 was a very good year for Starbucks financially, reflecting sustained upward momentum in our business; second, we are confident in our ability to deliver non-GAAP operating income growth of 8% to 10% in fiscal 2020, underpinned by revenue growth of 6% to 8%, demonstrating modest margin expansion even as we continue to invest for the long-term; and third, we remain fully committed to our long-term model of double-digit non-GAAP EPS growth.

I will begin by sharing segment highlights for our fourth quarter, and an overview of key trends across fiscal 2019, followed by our guidance for fiscal 2020.

Our Americas segment delivered 9% revenue growth in Q4, driven by comp sales growth of 6% and net new store growth of 3% over the past 12 months. Lapping 4% comp sales growth in Q4 of last year, our U.S. business delivered an impressive 6% comp sales growth in Q4 of this year, driven equally by transactions in average ticket. These results were led by an improved in-store experience, a strong beverage lineup and increased digital engagement as Kevin mentioned.

Transactions grew across all dayparts for the second consecutive quarter, and beverage led our comp growth for a fifth consecutive quarter, driving 5 points of comp sales growth with food contributing the remaining point. The majority of the beverage growth was driven by our cold platform, which grew across all dayparts, led by cold coffee, refreshment and tea. The Nitro Cold Brew platform, which reached full penetration of our company-operated stores by the end of Q4 and was supported by national advertising for the first time in August, continued to be well-received, drawing in more occasional customers and slightly favoring the afternoon daypart.

Our fall beverage lineup also performed extremely well, driven by the success of our pumpkin platform along with cold coffee and Nitro. Beverage attach, beverage mix and pricing contributed evenly to the 3% growth in average ticket for the quarter.

Americas' non-GAAP operating margin contracted by 100 basis points to 20.2% in Q4, primarily due to the one-time investment in our leadership conference as we've discussed on previous calls. Growth in wages and benefits, and increased investments in labor hours, to elevate the in-store experience while accommodating higher volumes. These increases in expense more than offset meaningful contributions from sales leverage and cost savings initiatives, notably supply chain efficiencies.

Moving on to our international segment, which delivered revenue growth of 6% on a reported basis in Q4. Excluding the unfavorable impact of Streamline related activities and foreign exchange at 5% and 1% respectively, revenue grew 12% in the quarter. This was driven by 11% net new store growth over the past 12 months and 3% comp sales growth. I would now like to highlight the fourth quarter performance of our lead international growth market, China.

New store development continues to be our number one driver of growth in China, and I'm pleased to say that our pace of development in Q4 set a new record as we opened 201 net new stores, growing store count by 17% versus the prior year. Importantly, our new stores continued to deliver exceptionally-high returns, even as we extended our presence to new cities while infilling established cities. China delivered comp sales growth of 5% in Q4, including 2% comp transaction growth, led by the strength in digital customer engagement, primarily the growth of Delivery, Starbucks Rewards loyalty program and MOP.

Our international segment's non-GAAP operating margin increased by 70 basis points to 21.7% in Q4. When excluding the 60 basis point favorable impact from Streamline related activities, the segment's non-GAAP operating margin increased by 10 basis points as the benefits of sales leverage, cost savings initiatives and labor productivity were largely offset by growth in wages and benefits, and unfavorable shift in product mix and strategic investments.

On to channel development. Revenue declined 6% in Q4, excluding the impact of Streamline related activities, primarily the Global Coffee Alliance, segment revenues increased approximately 5%. Non-GAAP operating margin declined by 510 basis points to 37.6% in Q4, when excluding the 310 basis point impact related to Streamline, channel development's operating margin declined 200 basis points in Q4 fiscal 2019 primarily due to an unfavorable shift in revenue mix.

I'd now like to take a step back and share some key insights from our full year performance, underscoring our upward momentum across the year. Let's start with revenue. For the year, we reported top line growth of 7%, excluding the 3% unfavorable impact of Streamline and foreign exchange combined, our revenues grew 10% above our long-term growth algorithm of 7% to 9%. These results demonstrate our potential to outperform our long-term model.

In the first six months of fiscal 2019, we reversed the negative trend in U.S. comp transaction growth that had persisted for several quarters and sustained it at 3% in the second half of the year. The turnaround in China's comp transaction growth moving from declines in the low to mid single-digits last year to an increase of 2% this year, was equally impressive especially considering our accelerated pace of store development in that market.

And speaking of China development, it's worth noting that our store openings in lower tier cities in China accounted for a meaningfully higher percentage of total store growth in that market versus the prior year. Yet portfolio investment returns remained very robust, demonstrating Starbucks resonance with China's growing middle class.

Our store development in the US was also quite healthy, as we grew net new stores by 3% in fiscal 2019 even with a higher level of closures relative to the prior year, as we repositioned our store portfolio for future growth. This is industry-leading domestic growth for our retail business of Starbucks scale and coupled with relatively-low penetration in certain geographies gives us confidence that we'll continue to achieve our 3% to 4% ongoing net new store growth target in the US.

Moving to margin. We reported consolidated operating margin of 17.2% for fiscal 2019 on a non-GAAP basis, down 80 basis points year-over-year and in line with our ongoing model of 17% to 18%. That said, I would like to highlight some anomalous items that impacted our year-over-year margin performance four headwinds and one tailwind. The four headwinds were 70 basis points from Streamline-driven activities, 50 basis points from US tax reform funded investments, 20 basis points from Siren Retail and another 20 basis points from our onetime investment in the Chicago Leadership Conference.

The one tailwind was 40 basis points from Stored Value Card breakage due to a change in accounting treatment. Adjusting for all these items, consolidated non-GAAP operating margin was up 40 basis points, reflecting the benefits of sales leverage and productivity improvements, partially offset by non-tax reform-funded investments in our partners, technology, product innovation and stores.

As Kevin mentioned earlier, we believe these investments are critical to strengthening our competitive position in order to sustain long-term growth consistent with our ongoing growth algorithm.

And, finally, EPS. We reported full year non-GAAP EPS of \$2.83, above the high end of our previous guidance. Excluding a 7% benefit from unplanned tax favorability and a 1% benefit from Streamline related activities, partially offset by a 1% headwind from foreign exchange, non-GAAP EPS growth was 10%, consistent with our long-term EPS growth model of at least 10%.

So, in summary, our fiscal 2019 results not only reinforce our confidence in the strategies we're implementing to grow the business, but also demonstrate the robustness of our long-term double-digit EPS growth algorithm.

Moving on to our guidance for fiscal 2020. Starting with the key driver of our growth, company-operated comp sales growth, globally, we are expecting comp sales growth of 3% to 4% in fiscal 2020, fueled by our two lead growth markets, the US at 3% to 4%; and China at 1% to 3%. All of this is consistent with our ongoing growth model.

Moving on to the next key growth driver, retail store development. We expect to add approximately 2,000 net new Starbucks stores globally in fiscal 2020, a sequential improvement over fiscal 2019. Over half will be located in the US and China combined, with China delivering approximately 600 net new stores, representing mid-teens growth versus the prior year. As with comp growth, this is consistent with our ongoing growth model.

With this combination of comp growth and unit growth, we are expecting enterprise-level top line growth of 6% to 8% in fiscal 2020. The 1 percentage point difference between next year's expected revenue growth and our ongoing growth model of 7% to 9% revenue growth is attributable to two things. Number one, the sale of our ownership interest in Thailand in mid-fiscal 2019; and number two, an expected 7% to 8% decline in channel development's revenue as we lap certain items related to the Global Coffee Alliance that benefited the segments top line growth in fiscal 2019.

Adjusting for these items, channel developments from revenue growth in fiscal 2020 is expected to be at the lower end of our ongoing range of 4% to 6%. The Global Coffee Alliance became EPS accretive in fiscal 2019, outperforming our original expectations. And we expect it to continue to be EPS accretive on a cumulative basis, including the associated share repurchase benefit funded in Q1 of fiscal 2019 by \$5 billion of after-tax proceeds from Nestle.

Let's move on to fiscal 2020 operating margin. Globally, and across each of our operating segments, non-GAAP operating margin is expected to improve modestly over fiscal 2019, primarily due to sales leverage, cost savings initiatives across our supply chain, and overhead efficiencies. The favorability from these items is expected to be partially offset by continued investments in our company-operated retail business, primarily related to our partners and technology. Let me add two additional points to the operating margin equation for fiscal 2020.

First, commodities are expected to have minimal year-over-year impact on cost of goods sold as we expect favorability in green coffee prices net of farmer support payments to be more than offset by higher dairy costs. At this point, our overall coffee needs are over 80% price locked for fiscal 2020.

Second, a few comments on G&A. Net of investments, we expect meaningful G&A leverage in fiscal 2020 due to organizational efficiencies, the completion of Roastery development and the lap of our leadership conference. The recent reclassification of certain line items in the middle of our P&L also meaningfully benefits G&A, while adversely impacting store operating expenses. As a result, while our long-term operating income margin target of 17% to 18% still includes a 100 basis point overhead efficiency improvement through fiscal 2021, it is now spread across G&A and store operating expenses.

Below the operating income line, we expect considerably higher interest expense, ranging between \$415 million and \$425 million in fiscal 2020 versus approximately \$330 million in fiscal 2019. This is driven by debt issuances totaling \$5 billion in the past 14 months, combined with what we expect to issue this fiscal year. Importantly, we remain committed to maintaining our leverage ratio below 3 times adjusted debt-to-EBITDAR.

As to the tax rate in fiscal 2020, we expect our effective GAAP and non-GAAP tax rates to be between 22% and 24%. This compares with a non-GAAP rate of 19.4% in fiscal 2019, which benefited from certain unplanned tax items that are not expected to repeat to the same degree in fiscal 2020.

Capital expenditures in fiscal 2020 are expected to total approximately \$1.8 billion, roughly flat to fiscal 2019, reflecting the opening of our final Roastery next month and the licensing of several company-operated markets. Over 80% of our capital spending in fiscal 2020 will be allocated to where we see significant return opportunities within our Starbucks retail portfolio, new stores and strategic store-related initiatives including renovations of existing locations.

Finally, at this juncture, we foresee minimal impact from foreign currency movements in fiscal 2020. So when you add it all up, our total revenue growth of 6% to 8% for fiscal 2020 is expected to translate into non-GAAP operating income growth of 8% to 10%, consistent with our ongoing growth model. We expect GAAP EPS in the range of \$2.84 to \$2.89, down slightly from fiscal 2019 due largely to the lap of the one-time gain attributable to the licensing of our Thailand operations.

We expect non-GAAP EPS in the range of \$3 to \$3.05, representing growth of 6% to 8%. Excluding the increase in our effective tax rate, as we lapped certain items that benefited fiscal 2019, this equates to expected non-GAAP EPS growth of 11% to 13% in fiscal 2020 consistent with our ongoing model of at least 10% EPS growth.

As a reminder, we expect the lap of income tax rate favorability from fiscal 2019 will impact our quarter-to-quarter non-GAAP EPS growth in fiscal 2020, with Q1 being the lowest at flat to down slightly, given a 9 percentage point EPS growth headwind tied to last year's tax rate. Additionally, with the lap of the leadership conference in fiscal 2019, we expect year-over-year non-GAAP EPS growth to be at its highest in Q4 for fiscal 2020. And with respect to quarterly cash flows, we expect to make a tax payment of approximately \$1 billion related to the Nestle transaction in early Q2.

So let me wrap things up. First, we are very pleased with our fiscal 2019 results. Second, we expect that fiscal 2020 will be another good year for Starbucks, delivering 8% to 10% operating profit growth. This demonstrates that we are executing very well from an operational perspective, underpinned by continued focus and discipline. And third, we are fully committed to our long-term model of double-digit non-GAAP EPS growth and will continue to make the investments necessary to sustain this growth over the long-term.

With that, Kevin and I are happy to take your questions joined by Roz Brewer and John Culver as Durga outlined at the top of our call. Thank you. Operator?

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] We'll pause for a moment to compile the Q&A roster. Your first question comes from the line of David Tarantino with Baird. Please proceed with your question.

David E. Tarantino

Analyst, Robert W. Baird & Co., Inc.

Q

Hi. Good afternoon. Congratulations on great results here. My question is on the Americas' traffic strength you've seen. It seems like you've picked up some momentum here. Even as you look at relative to last quarter, you were cycling a tougher comparison. So I was wondering if you could just talk about the elements that drove that? And whether operations, I know you said you saw traffic positive throughout all the dayparts. I'm wondering how big of an impact do you think operations had versus some of the product news you had during the quarter? Thanks.

Kevin Johnson

President, Chief Executive Officer & Director, Starbucks Corp.

A

David, thanks for the question. Roz, do you want to take that one for us?

Rosalind Gates Brewer

Chief Operating Officer, Group President & Director, Starbucks Corp.

A

Sure. I'll take that one. David, thank you for the congratulations. And it was a combination of both. So within the quarter, two things happened. Beverage innovation continued but we also promoted beverages pretty heavily in the quarter. And so we promoted what the plans were for early July beginning with our flavored iced teas. And then the fall beverage lineup highlighted by the pumpkin platform. And that helped immensely. In addition to the work that we've done to free up the work and the administrative work of our partners in the stores so that they can engage with the customers allowed them to have great interactions. And we were able to see that in all dayparts. Additionally, our drive through business continues to grow well and you'll see that continue through fiscal year 2020.

I will also mention that the work that we continue to do to engage our customers from a digital perspective has also been helpful, particularly when we introduced multi-tier redemption. And that's allowing us to speak with our occasional customer and they're engaged in both the afternoon as well as our happy hour business.

Kevin Johnson

President, Chief Executive Officer & Director, Starbucks Corp.

A

David, I'll just punctuate. The Growth at Scale agenda really is about delivering predictable sustainable growth. To do that, we've really sharpened the focus on the elements that Roz mentioned and are executing with discipline. So if you look at the three initiatives that we prioritized with this, elevate the experience in our stores, drive relevant beverage innovation for our customers, and grow digital customer relationships. Those three things are what's driving an all-time high in customer connection scores. That is in turn driving traffic growth.

And those same three priorities that we've focused on throughout fiscal year 2019 will be the same ones we continue to drive in fiscal year 2020 and that's part of what gives us confidence that we are pushing on the right elements that we think differentiates the Starbucks brand versus alternatives in the market, strengthens the connection between our partners and the customers, driving customer connection scores to an all-time high and in turn, driving traffic and growth.

Operator: Your next question comes from the line of Katherine Fogertey with Goldman Sachs. Please proceed with your question.

Katherine Fogertey

Analyst, Goldman Sachs & Co. LLC

Q

Great. Thank you. My question actually is about the new espresso machines that you guys were trialing and testing but looks like you're rolling them out a little bit more broadly here. Curious what kind of benefits you're seeing from the new machines, both in customer satisfaction, quality and throughput. How many stores have them and how long will it take for the whole base to, at least on the company-owned side, to get an upgrade to these new machines? Thank you.

Rosalind Gates Brewer

Chief Operating Officer, Group President & Director, Starbucks Corp.

A

Yes. So...

Kevin Johnson

President, Chief Executive Officer & Director, Starbucks Corp.

A

Go ahead, Roz.

Rosalind Gates Brewer

Chief Operating Officer, Group President & Director, Starbucks Corp.

A

So, Katherine...

Kevin Johnson

President, Chief Executive Officer & Director, Starbucks Corp.

A

[indiscernible] (40:58) Go ahead, Roz.

Rosalind Gates Brewer

Chief Operating Officer, Group President & Director, Starbucks Corp.

A

Katherine. Sure. So concerning the Mastrena machines that you're referring to for espresso engagement in our stores, yes, we are improving the number of Mastrena machines we have across the fleet. In addition to that, I think you're aware that we also placed Nitro machines in all of our U.S. company-operated stores as well. This is representing the work that we're doing with beverage innovation. We're continuing that expansion with Mastrena and should finish that work in the next 12 months or so.

Katherine Fogertey

Analyst, Goldman Sachs & Co. LLC

Q

And...

Kevin Johnson

President, Chief Executive Officer & Director, Starbucks Corp.

A

And, Katherine, there's three key benefits of this new Mastrena machine that I want to really punctuate. Number one is it can pull a triple shot of espresso with one pull. Today in our older machines you have to pull a doubleshot and then another single shot for any beverage that has three shots of espresso. So, just that alone reduces the amount of time that a partner at the bar would need to take if they're preparing a beverage that has three shots of espresso in it. So that's number one, big efficiency unlocked. Number two, those machines have Internet of Things sensors built into them. And so we get telemetry data that comes into our support center. We can see every shot of espresso that's being pulled and we can see centrally if there's a machine that needs tuning or maintenance and that allows us to improve the quality of the shots that we're pulling.

And third, with the Deep Brew and our predictive analytics, we're going to be able to determine if a machine needs preventative maintenance on it before it breaks. And so that simplifies things for our partners. John, you want to comment on the...

John Culver

Group President-International, Channel Development and Global Coffee & Tea, Starbucks Corp.

A

Yeah, I would just say, Katherine, on the international side, we're also rolling the machines out internationally as well. And I think the benefits that both Roz and Kevin hit on are important benefits that we're seeing translate into the international markets as well. I would also just add that our partners absolutely love these machines. And it gives them much more visibility to the customer due to the lower profile of the machine itself being able to interact with the customers and engage with them. And the benefits thus far are very meaningful for the business across all the markets.

Operator: Your next question comes from the line of Jeffrey Bernstein with Barclays. Please proceed with your question.

Jeffrey A. Bernstein

Analyst, Barclays Capital, Inc.

Q

Great. Thank you very much. Question relates to China. Clearly, it seems like you're back to solid mid single-digit growth the past couple of quarters. I'm wondering using 2020 hindsight here, maybe what you think were the greatest challenges over the four-quarter period or so where it seemed like the comp trends were really challenged? Whether you thought it was internal or macro or competition? What do you think kind of resurrected that business? And with that as a backdrop again having done mid single-digits the past two quarters, just wondering why you think the fiscal 2020 guidance for 1% to 3% is appropriate when it seems like you're on track and running ahead of that level? Thank you.

Kevin Johnson

President, Chief Executive Officer & Director, Starbucks Corp.

A

Thanks, Jeffrey. John, why don't you...

John Culver

Group President-International, Channel Development and Global Coffee & Tea, Starbucks Corp.

A

Yeah, I think, Jeffrey, what we're seeing in China is a direct result of the digital footprint that we've been able to build there as well as the meaningful innovation that we're bringing with products and Modern Mixology and then the innovation that we're doing around our store footprint. And digital obviously is moving very fast. And for us, as

Kevin highlighted in his comments, digital orders represent 10% of the business that we saw in the quarter. 7% of that coming through delivery, which is an entirely new channel for us and then 3% is coming through Mobile Order & Pay. So, digital has had a meaningful impact, a positive impact on the business.

And just beyond the comp performance, we talk a lot about the acceleration of the store footprint. And we had record new stores opened in the quarter. We continue to see very strong economic returns. We continue to see very strong revenue growth of 18% in the quarter. Majority of that is driven by new stores. And then new customers and existing customers frequenting our stores, total transactions in the market grew a solid double-digit for another quarter, which is great results by the team. So, feel very confident about our position in China and the work that the team is doing there.

Kevin Johnson

President, Chief Executive Officer & Director, Starbucks Corp.

A

Pat, why don't you take the second question around that, the long-term Growth at Scale growth model and specifically the way we think about our comp guidance in China?

Patrick J. Grismer

Chief Financial Officer & Executive Vice President, Starbucks Corp.

A

Absolutely. Jeff, we are very pleased with our overall momentum that we're seeing in our business. But it's premature to revise the ongoing long-term guidance that we've provided at our 2018 Investor Day. Our policy is to guide conservatively. Communicating the expected outcomes that we have a high degree of confidence we can deliver. It's the predictable sustainable growth that Kevin referenced earlier.

Specifically, in relation to China, the market dynamics there that are impacting our comp are unchanged from where they were a year ago. We are continuing to open new units at an accelerated pace. And, of course, that puts pressure on existing units through sales transfer. We're also continuing to see a slower overall growth rate in the economy. And we're seeing a more intense level of competition. I would say in part because of the success that we've enjoyed and the opportunity we've highlighted in the specialty retail coffee category.

So, when you take all of those together, we believe that it is prudent to guide to comp growth in China in the range of 1% to 3%, again, consistent with our ongoing model, we're delighted with the performance of the business this past year, but it's – and we certainly are optimistic about our ability to sustain the strong performance into fiscal 2020. But we believe it's prudent to reaffirm our guidance of 1% to 3%.

Operator: Your next question comes from the line of Sara Senatore with Alliance Bernstein. Please proceed with your question.

Sara Harkavy Senatore

Analyst, AllianceBernstein L.P.

Q

Thank you. I wanted to ask a bit about some of the investments you've talked about making, whether it's in the Americas or in China perhaps because with such good comps, you talked about a little bit of the offset and headwinds from some of these investments. So, in the Americas, when I look at the store operating expenses, it looks like it's grown a bit faster than top line. Should we expect that to be the case going forward? Which is to say, this year was more like a step-up in some of the investments you were making in your partners or should we just expect that going forward in order to sustain the kind of service levels and customer and partner engagement you have, you're going to probably need to continue to invest at this pace?

And then with respect to China, if you could just talk about investments there, maybe even in the product mix you talked about as being unfavorable. Is it value or is it just food or other things that are going on? Just some of the margin headwinds specifically, please.

Kevin Johnson

President, Chief Executive Officer & Director, Starbucks Corp.

A

Pat, Why don't I let you take that with Sara and then we'll see if Roz and John need to add to it. Why don't you go ahead and lead?

Patrick J. Grismer

Chief Financial Officer & Executive Vice President, Starbucks Corp.

A

Okay. Thank you, Kevin. Sara, what I'd like to do first is maybe take a step back and talk about Q4 in total. In my prepared remarks, I talked about consolidated margin across all of fiscal 2019. I'd like to focus more specifically on Q4 here, because the dynamics were a bit different. So, on a recorded basis, our non-GAAP operating margin of 17.2% represented a 90-basis-point decline compared to Q4 of last year. What I would highlight is that embedded in that is a 70-basis-point impact from our leadership conference as well as a 30-basis-point impact from streamline-driven activities. So when you exclude those, our non-GAAP operating margin actually improved 20 basis points.

Now, I think to your point, admittedly a 20-basis-point margin improvement seems very modest in the context of a 5% level sales comp for the quarter, particularly in relation to other quarters. So, what I like to do is highlight what was unique to Q4 including recent trends impacting our flow thorough, which primarily relates to two margin drivers within our Americas' segment. The first driver relates to the investments we're making to sustain long-term growth. Exactly to your point. Along with the tax reform funded investments in partner wages and benefits that we initiated in fiscal 2018, we invested in additional labor hours in Q4 to build on our positive sales momentum, drive higher levels of customer connection and explore opportunities to unlock capacity in stores that we believe are best positioned to capture incremental sales at peak.

This effort tested the upper limits of investment potential to determine where the future payback could be greatest in terms of incremental sales. This investment was not intended to completely pay back during the quarter. However, it provided us, and this was our goal, with a substantial amount of data. And we're leveraging these insights to optimize our labor deployment going forward. This is the artificial intelligence and machine learning that Kevin referred to earlier. So in addition to those labor hours, we also invested in store-level equipment as Roz mentioned to support new product platforms like Nitro Cold Brew and to improve our operating efficiency.

So that's the first driver is really in the area of investments. The second driver relates to inflationary pressures in wages and benefits as well as occupancy expense. Now, consistent with our discussion in Q3, we are seeing margin pressure from continued increases in statutory minimum wages coupled with inflationary increases in rent, common area maintenance and real estate taxes. All that said, we do expect modest margin expansion in fiscal 2020 as we've guided as we continue to balance our investments with expected benefits from sales leverage and ongoing cost savings initiatives notably in our supply chain.

Now, I'd also like to take a minute or two to talk about China because the dynamics there are slightly different. We do expect to continue to make investments there in order to sustain strong comp growth even as we have accelerated our pace of development. But one thing that is slightly different is product mix. Product mix in the last year and we foresee this continuing into fiscal 2020 is a bit of a headwind in China. And one of the drivers of that is the growth in our delivery sales mix. As we've discussed before, delivery transactions are on the margin dilutive to our total margin. However, they are highly incremental.

So even while diluting our margin percentage, they grow total profit dollars. And that is different from what we are seeing in the US, where delivery is in the very early stages and growing more modestly. So that is probably the key difference between China and the US. But what is consistent across both and is an important part of our strategy going forward is continuing to make those strategic investments in our business that strengthen key points of competitive difference and help us to sustain top line growth for the long-term. But it does come at the expense of what would otherwise be much stronger margin expansion on the back of the consistent comp growth that we're expecting going forward.

Operator: Your next question comes from the line of David Palmer with Evercore ISI. Please proceed with your question.

David Palmer

Analyst, Evercore ISI

Q

Great. Thanks. Good evening. Question on the key drivers. Between the US and China, even as I listened to this call, it sounds like there's an interesting contrast where China's more of a digital flywheel story with that 45% growth in Rewards. And you had that big jump-up in digital order partly fueled by delivery. And the US, you've had that mid-teens growth in Rewards users, but all the while, this year you've been ramping up as your cold beverage growth seems to be ramping. So, I wanted to ask you, do you agree with that characterization in terms of the top drivers in each market? And how do you think those will play out in fiscal 2020? Thanks.

Kevin Johnson

President, Chief Executive Officer & Director, Starbucks Corp.

A

Yeah, let me just frame kind of my thinking at a high level, David. Then I'll hand over to Roz and John to comment specifically on US and China. I do think that where we're focused on the same key things to create a great experience in our stores, to drive beverage innovation that's relevant to our customers, and to grow digital customer relationships, the two markets are very different. Clearly in China, this past year, we've seen a significant step forward in our digital customer relationships. A lot of that driven with our China digital partnership with Alibaba. We introduced a spend-based Rewards program in December. We launched the ability for mobile order for pickup. We launched Starbucks Delivers. And in China, what you see is the consumer base in China is much more digitally savvy than any other market in the world.

You just look at the percent of tender that's paid on the mobile app with Alipay or WeChat Pay. You look at the number of scenarios in China that are digital, mobile scenarios. And so the work that Belinda and Leo and our great China leadership team did this year in many ways was anchored around taking a big step forward in the digital flywheel. And that's where a year ago, we didn't have mobile ordering for pickup or delivery. Now, 10% of our sales mix is coming from that with 7 points from Starbucks Delivers and 3 from mobile order for pickup.

In the US, I think in that particular market, we've had a digital flywheel and the active Rewards member growth for several years now. And I think in the US, a lot of this was continuing to extend and accelerate that, but I think more importantly, the work that's gone into creating elevating the customer experience in our stores, and really sharpening our focus on the beverage innovation, while at the same time, expanding digital customer relationships has helped.

Delivery is Starbucks Delivers in the US still is very small. It's less than 1% of our sales mix. And I think part of that is because the cost dynamics are different in China versus the US. And I think the Chinese consumer is much more advanced in these digital scenarios than in the US. But I think we're going to continue to watch and see

how that evolves in the US. Let me hand over to – I guess the net is, David, I think we do have two very different markets with the consumer behavior and the state of evolution of Starbucks and our capabilities in those markets continues to evolve in a way that's relevant to the customer mix in each of those two markets. Roz, why don't you add the things you think are important on the US side and then, John, why don't you do the same on China.

Rosalind Gates Brewer

Chief Operating Officer, Group President & Director, Starbucks Corp.

A

Sure. I'll just add a few things here, just to highlight that we're still seeing growth in our digital flywheel. Just in this quarter alone, our loyalty programs contributed nearly 2 points of comp and that's making up about 42% of our tender right now. And typically in the fourth quarter, where we usually see retraction, we actually saw active member growth of about 15% year-over-year approaching almost 18 million members. And then the new Starbucks Rewards, which we're calling Starbucks Rewards 4.0, we're seeing good performance in our 90-day active consumers. And it's in line with our expectation. So, we're still seeing improvement in growth in our relationships, in our digital platforms, and we'll continue to see that as we get into fiscal year 2020.

John Culver

Group President-International, Channel Development and Global Coffee & Tea, Starbucks Corp.

A

Yeah, and, David, from a China standpoint, I agree with what Kevin's comments were around the Chinese consumer and their digital capability and the savvy that they have. Just to put that into context, you've seen in our report, our reported earnings, the growth of the Starbucks Rewards program. So, we up-leveled that in December. We now have crossed the 10 million Starbucks Rewards members in China. We grew that 45% year-over-year. And our total member base is now in China sitting at 32.5 million, which is up 66% over a year ago.

So really just strong digital engagement from the customers. When you drill down a little bit deeper into MOP, we've expanded MOP at [ph] China-speed (59:53). We're now in more than 2,600 stores across 15 cities, and we're continuing to expand that program. So, we've got about 65% of our store base covered. We're seeing a very strong healthy repeat on purchases. We're – which is enabling us to bring new users into the Starbucks Rewards program, and penetrate that more deeply.

And then you translate that into the new channel of delivery. We're seeing good success in delivery. We stand out over 3,000 stores in 100 cities. We now cover 80% of our store base. As we said, 7% of the sales mix, we're seeing a higher ticket through delivery, and stronger food attach. And we're seeing morning and lunch daypart increasing. So very optimistic about that.

And then just, don't lose sight of the need for us to continue to gain first mover advantage on store growth. And we're going to continue to focus on accelerating our store growth. Clearly the returns that we see in terms of new stores indicate that there is a lot of opportunity in that area. And as we continue to cultivate the coffee consumption in China, which now sits at less than four cups per year per person compared to 300 in the U.S., this is a huge opportunity.

And then just one other thing and then I'll stop, is the Global Coffee Alliance. And as Kevin shared, we spent the last few days in China, we're here in Japan today, talking about the opportunities the Global Coffee Alliance has for us in China. And we've announced that in August, we're rolling out across four platforms. We have over 20 products that we've launched. We walk the aisle in Shanghai, the Starbucks presence is absolutely stunning. And then food service is going to be a big opportunity as we focus in on office, as we focus in on universities, and as we focus in on the five-star hotels. So, we're very optimistic about China.

Operator: Your next question comes from the line of John Ivankoe with JPMorgan. Please proceed with your question.

John Ivankoe

Analyst, JPMorgan Securities LLC

Q

Hi. Thank you. Yeah, first, I'm actually just going to stay on the Global Coffee Alliance. I think it was – you said there was a 7% to 8% of reduction in revenue relative to some things that happened in 2019. I was just hoping you could talk about that. And just the comments that were being made on accretion after buy-back, just seemed to be interesting that they were made at all. Just overall, from a profitability perspective, as we think about that segment with fiscal 2020 in line with, relative to what you've originally thought. And if not, why? And then I'll have a couple follow-ups?

Kevin Johnson

President, Chief Executive Officer & Director, Starbucks Corp.

A

Pat, why don't you take that if you could?

Patrick J. Grismer

Chief Financial Officer & Executive Vice President, Starbucks Corp.

A

Certainly. So, John, what I'd like to highlight is what is driving the difference between our total revenue growth guidance for fiscal 2020 and our long-term growth model. So we've guided to a range of 6% to 8%. Our long-term growth model is 7% to 9%. That 1 percentage point difference is attributable to two things.

One is, the sale of our ownership interest in Thailand in fiscal 2019, and how that extends then with its impact into fiscal 2020. But then the second is, and I think this is more directly to your question. What we're expecting by way of a revenue decline in channel development from fiscal 2019 into fiscal 2020, even though we have lapped the onset of the Global Coffee Alliance.

There were some temporary business transition activities in fiscal 2019 that are nonrecurring and they tend to mask the growth profile of our channel development business for fiscal 2020. And they relate primarily to lapping some elevated inventory sales to Nestlé in preparation for their direct fulfillment of customer orders, in addition to what were some final sales of Tazo branded products that fell into fiscal 2019. So when we normalize for these temporary transition items in channel development as well as for the ownership change in Thailand, we get back to a normalized total revenue growth rate of 7% to 9%.

What I would like to highlight specifically in relation to channel development given that we are guiding to an adjusted revenue growth rate of, I know, 4% which is at the bottom end of our ongoing range of 4% to 6%, is that we would expect it to be 4% to 5% in the near term, and then 5% to 6% longer term with what we expect by way of an accelerated pace of international market expansion. So really, what you see happening is a combination of things. Number one, it's overlapping some unusual benefits that we realized in fiscal 2019, but it's also the fact that the international market acceleration and how that impacts the shape of our revenue growth for the channel development segment particularly, we see happening further out into the future.

Kevin Johnson

President, Chief Executive Officer & Director, Starbucks Corp.

A

John, do you want to just comment on the international market expansion on Global Coffee Alliance kind of what we achieved in fiscal 2019 and the outlook for fiscal 2020?

John Culver

Group President-International, Channel Development and Global Coffee & Tea, Starbucks Corp.

A

Yeah, so we've had some great work that's happened between us and Nestlé as we rolled out this Global Coffee Alliance. Clearly, the US market is the most established business. We had a smaller business in Europe but then the rest of the world was greenfield as it relates to CPG and Foodservice channels.

We now have products available in over 30 markets around the world. And as Kevin highlighted, we're on our way to having 50 markets up and running by the spring of 2020. We've got 28 SKUs that we've launched across four different platforms, particularly the work that we've done with Nespresso is paying dividends. We're seeing very good strong growth and uptick for the Nespresso Starbucks-branded capsules. We're also seeing very good strong uptick with Dolce Gusto on the Dolce Gusto platform. So we're very optimistic about the single-serve opportunity that exists around the world, not just in the US.

We did have a meaningful launch of creamers in the US, and we anticipate that – taking that to other markets. We've launched four flavors in August. And we earned about 10.4 billion impressions as we made that announcement. So there is a lot of consumer excitement about this. And a lot of market excitement. And then we're going to continue to drive meaningful innovation within the Global Coffee Alliance. I think at the speed of which we've been able to create the product platforms, the speed at which we've been able to bring those into the markets, that is going to continue. And that's been a big piece of the discussions that we've been having here over the last two-and-a-half days with the Nestlé team. And we're both very optimistic about the opportunity going forward.

Patrick J. Grismer

Chief Financial Officer & Executive Vice President, Starbucks Corp.

A

And, John, there was a second part to your question in relation, I believe, to the EPS accretion from the Global Coffee Alliance. So just to reaffirm, the Global Coffee Alliance became EPS accretive in fiscal 2019 which is faster than we'd originally expected when we completed the transaction. And we continued to expect even with that revenue decline that I mentioned, we continue to expect that it will remain EPS accretive on a cumulative basis and that includes the beneficial impact of the share repurchases that were funded with the after-tax upfront cash payment from Nestlé.

Operator: Your next question comes from the line of Sharon Zackfia with William Blair. Please proceed with your question.

Sharon Zackfia

Analyst, William Blair & Co. LLC

Q

Hi. Good afternoon. I actually had two questions, ones pretty quick. I know in the past you've talked about the digital information you have now on people who are not yet Rewards members. And I think you've given that number in the past. I'm just curious if that continues to grow in the U.S.

And then secondarily, on the margin outlook, I guess I'm a little confused on the Americas, particularly. I know the margin there is stabilized, so you had some benefit from the change in the gift card breakage. So I'm just wondering whether or not we should expect Americas margins to stabilize or not in 2020 as well?

Kevin Johnson

President, Chief Executive Officer & Director, Starbucks Corp.

A

Thanks, Sharon. Roz, why don't you take the first question on digitally-registered customers that Sharon asked? And then Pat, why don't you take the margin question if you could? So, Roz?

Rosalind Gates Brewer

Chief Operating Officer, Group President & Director, Starbucks Corp.

A

Great. Thank you. So just on those digitally-registered customers that we've seen in this recent quarters, first of all, we've seen the redemption shipped into new tiers. And that's not impacting our overall Starbucks Rewards growth. The customers we've seen, they've embraced the choices provided by these multiple redemption tiers. The 150 star tier continues to see the majority of the redemption volume. And we've also seen that our low-frequency members that you've heard us refer to as our occasional customers, they're driving a more significant portion of the active members. So right now, we're seeing good movement in that space. And, again, our Starbucks Rewards customers, we've seen acceleration there in that member growth of about 15% to roughly 18 million members. Actually, that number is 17.6 million.

The other thing I'll mention is that we continue to grow at peak in our morning peak timeframe. And we're seeing actually growth across all dayparts, that occasional customer that we're introducing to Starbucks Rewards is coming in, in the afternoons. And so we – that's how we are seeing the lift through all the dayparts. And so that is the work that's happening by adding the new multi-tiers to the program.

Patrick J. Grismer

Chief Financial Officer & Executive Vice President, Starbucks Corp.

A

And then, Sharon, with respect to your questions on margin, what I first want to clarify is that we are expecting modest margin improvement across each one of our segments in fiscal 2020. Specifically, on the Americas, you asked about breakage and then just Americas margin generally. So I first want to clarify what's happening with breakage. As a reminder, we adopted this new revenue recognition accounting standard starting in the first quarter of fiscal 2019, and one impact of that was to reclassify stored value card breakage from the interest and other line below operating income and outside of segment results to the revenue line at the segment level. It's mostly a matter of P&L geography that does not have an impact on EPS. On a full-year basis, the change in accounting did have a beneficial impact to non-GAAP operating margin of about 40 basis points in fiscal 2019, and the greatest impact was in Q2 due to seasonality.

But I also want to clarify that breakage is not accounted for in comp sales. It's just another revenue driver after new stores and comp sales. We will lap this impact in the first quarter of fiscal 2020, at which point the benefit to our revenue and operating margin will already be embedded in our base. So breakage will not be a driver of margin performance in fiscal 2020.

We do expect in the Americas, like the other segments, that there will be modest margin expansion in fiscal 2020. And that's a function of the sales leverage that we expect from the comp growth that we're guiding in the range of 3% to 4% as well as the significant cost savings that we're expecting, particularly in our supply chain, and that that will be sufficient to offset the investments that we're looking to make in fiscal 2020 to continue to drive the top-line. I will also say that the Americas margin will benefit in 2020, fiscal 2020 from the lap of the leadership conference in the fourth quarter. So as you think about the shape of our margin performance across the year, what that means is that we'll probably be flattish in Q1. We'll see that modest improvement in Q2 and Q3, and then we will see a very robust margin improvement in the fourth quarter.

Operator: Your next question comes from the line of Matthew DiFrisco with Guggenheim Securities. Please proceed with your question.

Matthew J. DiFrisco

Analyst, Guggenheim Securities LLC

Q

Thank you. I just have a follow-up a little bit there on Sharon's also. With respect to the incremental of that 17.6% and the 15% growth, can you dig into that and see sort of, are you seeing a little bit of a broader demographic maybe coming onboard than you had in the past? I know that there were some theories out there in the last couple of years when it did decelerate that perhaps the brand was hitting its max as a premium position brand. I'm curious as far as just your overall value perception. And are you may be seeing also did the tier, the change to a tiered Rewards program, has it opened you up maybe to a broader demographic that maybe you're resonating better as a value and you're expanding the tent to include more people of maybe lower incomes than you have in the past?

Kevin Johnson

President, Chief Executive Officer & Director, Starbucks Corp.

A

Roz, why don't you go ahead and take that for us.

Rosalind Gates Brewer

Chief Operating Officer, Group President & Director, Starbucks Corp.

A

Okay. Great. Thanks, Kevin. So what we are seeing is that we are seeing a broader array of customers that are attracted to Starbucks at the moment. In terms of qualifying their demographic to understand that they're value or non-value, we don't have that kind of data at this point. But I will tell you that we know that they are attractive to the beverage program, less attractive to the food program at this time. We are encouraged by the ticket that we're seeing with this customer and their attraction to things like happy hour and also to the time of day.

And so as we'll learn more we'll share that with you. But right now, we're encouraged that we are moving these customers to the Starbucks Rewards level. And we're pleased that we did add the other layers of redemption just so that we can expand the excitement of the Starbucks brand to a broader customer. So we'll come back to you with more information on that. But right now, we don't have the demographics on those customers.

Kevin Johnson

President, Chief Executive Officer & Director, Starbucks Corp.

A

Let me just add a comment on the strength of the Starbucks brand. Growth at Scale has really enabled us to really sharpen our focus on those things that we believe differentiate Starbucks from all other opportunities and all other experiences. So the focus that we've put on the customer experience in our stores, the focus we've put on beverage innovation, the focus we've put on digital customer relationships, and the fact that we have executed against this with discipline has driven our customer connection scores to an all-time high.

The brand is healthy and strong and growing. And so in many ways our Growth at Scale agenda has really enabled us to put our energy behind the things that matter most. And the things candidly that differentiate us from all others in the marketplace. And I think that is a significant reason why we're seeing transaction traffic growth. We're seeing comp growth. And we're seeing momentum across all aspects of Starbucks. And that is helping us in many ways, both digitally, but it's also more importantly really amplified for the experience that our Starbucks partners who proudly wear the green apron create for our customers each and every day.

Operator: The last question today comes from Dennis Geiger with UBS. Please proceed with your question.

Dennis Geiger

Analyst, UBS Securities LLC

Q

Great. Thanks for the question, just wanted to quickly touch a bit more on some of those key drivers that you talked about in the U.S. And I guess specifically, as you kind of think about beverage, the in-store experience, as well as digital looking ahead, just anything incremental you could say about that beverage pipeline. Obviously, Nitro is relatively new across the system, but about how you feel about that beverage pipeline looking ahead. How much incremental opportunity there is on the in-store experience? And I guess similarly with digital, a lot of commentary there but just where you go from here? If you'd characterize what inning and just the opportunity, that would be great. Thank you.

Kevin Johnson

President, Chief Executive Officer & Director, Starbucks Corp.

A

That's great. Roz, why don't you take that for us?

Rosalind Gates Brewer

Chief Operating Officer, Group President & Director, Starbucks Corp.

A

Sure. There's a couple reasons why we feel confident about our future in what we've been doing with beverage innovation. The work we've been doing with in-store experience and our digital engagement. First of all, behind the scenes a lot of the work we've done in-store is around the work that we did with the team works' rollout in third quarter fiscal year 2019. And so we'll benefit a lot from that in fiscal year 2020. Then there's significant work in progress around inventory routines and automation, the food prep tests that we do, backroom optimization, and all of those items are fueling the work as Kevin mentioned around machine learning and our applications to fuel deep brew.

So we feel confident about that work that's ongoing and it is already in process. And in terms of beverage innovation, because we have been looking at not only beverage innovation but equipment, having Mastrena there as an opportunity, having Nitro there, we introduced cold foam last year. It's allowing us to create new beverage combinations that our customers are really responding to in addition to the growth in cold. So, if you look at our sales in detail, cold, which is our Refreshers, our iced teas, our cold coffee, and our Nitro Cold Brew, are all doing extremely well for us, and so that innovation will be ongoing.

And then from the point of the digital relationships, the more we learn about our customer base, the better we have been marketing to them. And so you will see our marketing become more personalized, and that will help with retention, and driving frequency in our stores. So, we feel like there's more to come in those three areas. So we'll continue on the pathway with those three important initiatives for us because there's still more to be done in those areas.

Operator: That was our last question today. I will now turn the call over to Kevin Johnson for closing remarks.

Kevin Johnson

President, Chief Executive Officer & Director, Starbucks Corp.

Thanks, Hector. As we close today's call, I want you all to know how much we appreciate the support and the encouragement we've received from the investment community over this past year, as we've undertaken significant efforts to streamline the company, sharpen our focus and drive improvements in operating performance. This would not be possible without the 400,000 talented Starbucks partners that I have the privilege

to serve each and every day. Together, we look forward to a great year ahead and to sharing our results and our progress in future quarters. Thank you.

Operator: This concludes Starbucks Coffee Company's fourth quarter and fiscal year 2019 conference call. You may now disconnect.

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