28-Apr-2020

Starbucks Corp. (SBUX)

Q2 2020 Earnings Call

CORPORATE PARTICIPANTS

Durga Doraisamy
Vice President-Investor Relations, Starbucks Corp.

Kevin Johnson
President, Chief Executive Officer & Director, Starbucks Corp.

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

Rosalind Gates Brewer
Chief Operating Officer, Group President & Director, Starbucks Corp.

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

OTHER PARTICIPANTS

David Palmer
Analyst, Evercore ISI

John Ivankoe
Analyst, JPMorgan Securities LLC

Sharon Zackfia
Analyst, William Blair & Company, L.L.C.

John Glass
Analyst, Morgan Stanley & Co. LLC

Sara Harkavy Senatore
Analyst, Sanford C Bernstein & Co., LLC

David E. Tarantino
Analyst, Robert W. Baird & Co., Inc.

Jeffrey A. Bernstein
Analyst, Barclays Capital, Inc.

Dennis Geiger
Analyst, UBS Securities LLC

Katherine Fogertey
Analyst, Goldman Sachs & Co. LLC

Brian Bittner
Analyst, Oppenheimer & Co., Inc.

Andrew Charles
Analyst, Cowen and Company

Matthew DiFrisco
Analyst, Guggenheim Securities LLC

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

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 Second Quarter Fiscal Year 2020 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 second quarter fiscal year 2020 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 and quarterly report on Form 10-Q. In addition, in some cases, we estimate the impact of COVID-19 by comparing actual results to our previous forecast. These forecasts were created prior to the spread of the virus, were based on information available at the time, and on a variety of assumptions, which we believe were reasonable, but some, or all of which, may prove not be accurate. Starbucks assumes no obligation to update any of these forward-looking statements or information.

GAAP results in fiscal 2020 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 a reconciliation of certain non-GAAP financial measures referenced in today's call with their corresponding GAAP measures. This conference call is being webcast, and an archive of the webcast will be available on our website through Friday, May 29, 2020. Finally, for your calendar planning purposes, please note that our third quarter fiscal year 2020 earnings conference call has been tentatively scheduled for Tuesday, July 28, 2020.

I will now turn the call over to Kevin.

Kevin Johnson

President, Chief Executive Officer & Director, Starbucks Corp.

Good afternoon, and welcome. Around the world, people, frontline responders, governments and businesses are all navigating extraordinary times. On behalf of Starbucks, I want to extend our deepest compassion and empathy for all those impacted by loss of life, feelings of anxiety and isolation and fears of both health and economic uncertainty during this pandemic. It was just three weeks ago in the spirit of continued transparency, when Pat and I shared with all stakeholders our second intra-quarter update on how COVID-19 has impacted our business and how we are responding. Today, continued recovery in China strengthens our belief that these impacts are temporary, and that we will emerge from this global pandemic with new insights and capabilities that will make our business even stronger and more relevant.

The principles we develop to drive our decision-making since the pandemic started in January are serving us well, bringing focus to our response and recovery effort, the three simple principles are; prioritizing the health and well-being of our partners and customers; playing a constructive role in supporting health and government officials as they work to mitigate the spread of this virus; and showing up in a positive and responsible way to serve our communities. In our update to stakeholders on April 8, we shared that the positive business momentum that drove one of the strongest holiday seasons in the history of our company continued well into our second quarter in the United States. Our performance was obviously disrupted by the impacts of COVID-19, but we are confident that the Starbucks brand is well positioned, and that our growth at scale agenda remains intact and will propel future growth when we emerge from this current crisis.

I will share some notable highlights from Q2 and then offer some perspective on how we expect to recover our business over time. Q2 was shaping up to be an exceptional quarter for Starbucks, driven by strong performance in the US and Channel Development, even while we were simultaneously navigating the impact of COVID-19 in China. However, near the end of the quarter, the pandemic started to materially impact our business outside of China, both significantly in the US. As a result, consolidated revenue in Q2 was $6 billion, reflecting a 5% decline compared to prior year primarily due to a 10% contraction in comparable store sales globally, driven by temporary store closures, modified store operations and slower traffic, partially offset by strength in Channel Development. In China, where the pandemic impacted our business for most of Q2, revenue and comparable store sales declined year-over-year by $325 million and 50% respectively.

Today, almost 100% of our stores in China are open. Many with limited seating, reduced hours and other safety protocols in place. Starbucks stores that remain closed in China are primarily located in cinemas and in closed entertainment venues, along with international travel hubs and certain tourist zones where restrictions are still in effect. Since we started reopening stores in late February, we have seen meaningful improvements in China comparable store sales in commercial, residential and office locations. We are also seeing the mix of in-store sales continuing to rise. For the month of April, comparable store sales in China were down approximately 35%, marking strong improvement from a weekly low of minus 90% in mid-February.

Importantly, even though new store development activities were suspended for most of the quarter, we opened 59 net new locations in China during Q2, and another seven locations added thus far in April. We are expecting to open at least 500 net new stores in fiscal 2020 with as many as 100 new stores originally planned for this year, deferred to fiscal 2021. This represents a rapid re-acceleration of our new store development and speaks to the amazing spirit and enormous capability of our team in China. Given this progress, we believe our recovery plan is working and we remain optimistic about our ability to capitalize on the long-term growth potential of the premium coffee market in China. We believe, barring any new disruptions, that our business in China is on a path to substantial recovery by the end of this fiscal year.

Just last week, we launched the Starbucks GOOD GOOD marketing campaign which features plant-based alternatives in products and packaging. With this program, Starbucks in China introduced Oatly, a plant-based milk alternative. Also, Starbucks is the first in China to offer national distribution of Beyond Meat's plant-based proteins, with new Asian menu items served in packaging made from plant-based materials. This campaign is just one step in our larger aspiration to be planet positive, while introducing relevant menu choices for customers. Over the past 20 years in China, we've established an admired and trusted brand by investing in our partners and delivering a unique premium experience to our customers.

We continue to play the long game in China as we invest in our future. The state-of-the-art Coffee Innovation Park that we will be opening outside Shanghai in 2022 will serve as a key component of Starbucks' worldwide coffee roasting network for customers in China and is a testament to the growth opportunity we see for specialty coffee in the market. Starbucks premium customer experience is highly differentiated in China, and the brand is as strong as ever. We continue to thoughtfully invest in China, a market that has significant long-term growth potential for Starbucks. I am proud of how Starbucks China continues to pave the way as one of our two lead growth markets.

Now, onto the other lead growth market for Starbucks, the US. Coming off one of the strongest holiday quarters in the history of Starbucks, US momentum continued to build well into Q2. Prior to mid-March, revenue growth in US was accelerating to the strongest level in over four years, driven by comparable store sales growth of 8%, including comparable transaction growth of 4%. Additionally, two-year comps were tracking to 12% growth, the strongest in over three years. With growth across all dayparts and strong contributions from both our Starbucks Rewards members and occasional customers, it is very clear that our focus on the customer experience, beverage innovation and digital customer relationships is a powerful combination.

Our performance was interrupted mid-March when a national emergency was declared to mitigate COVID-19. And we decided to close over 50% of our company-operated stores and limit service to drive-thru and delivery for those that remained open. In that final three weeks of Q2, US comp sales swiftly decelerated, ending the quarter down 3%, driven by a 7% contraction in traffic comp. Based on the experience we gained navigating COVID-19 in China, we have been as well prepared as anyone for this mitigate-and-contain phase in the US, particularly as our stores are well positioned to adopt operational safety protocols while still meeting our customers' needs. In the US, almost 60% of our company-operated stores include drive-thru, and over 80% of our customer occasions before the crisis were on-the-go, with the majority of these orders being placed at the drive-thru or by using the Starbucks app to mobile order for pickup or delivery.

Of note, during the second quarter, 90-day active Starbucks Rewards members, our highly routinized, highly engaged and loyal customer base with whom we could directly communicate digitally, increased to 19.4 million in the US, up 15% from a year ago. Since the crisis started, we have seen an average ticket growth increase throughout the quarter, a result of group ordering as customers through this pandemic are making Starbucks runs for their homes, local essential businesses and for frontline response teams. Overall, Nitro Cold Brew and refreshment continue to lead for beverage and our new alt milk beverages, Almondmilk Honey Flat White and Coconutmilk Latte are also resonating well with customers. Our innovation in food, notably our new breakfast wraps have surpassed expectations to date.

Similar to our experience in China, we are transitioning into a new phase of operations we call monitor and adapt. We are now leveraging digital tools that enable us to monitor the COVID-19 situation in every community across the US, and leverage a variety of service options from contactless service, entryway pickup, curbside delivery where parking is available, and at-home delivery that allow us to thoughtfully reopen stores and scale up operations. We are finding new, innovative ways to serve our communities, prioritizing the safety of our customers and partners with a focus on exceeding public health standards and adjusting to new customer expectations. The strength of our digital reach, combined with the range of service options is enabling us to reopen stores, community-by-community, in a thoughtful way, using the three simple principles that have guided our response thus far.

Our monitoring capability provides the input necessary for decisions that enable us to turn the dial up or down depending on the situation in a specific community or a specific store. This is the beginning of the recovery as we reopen stores beginning in early May and we expect to have approximately 90% of all company-operated US

Starbucks stores reopened by early June with enhanced safety protocols and modified schedules. We are also sharing our store safety protocols with our licensees across the US who continue to responsibly operate their stores, particularly in grocery locations across the country.

My summary on our US business is this; this monitor and adapt phase in the US is the inflection point for reopening stores and begins a recovery process that requires ongoing monitoring community-by-community to rapidly adapt and drive the recovery.

We are well-positioned to leverage our digital assets and new operating formats, like contactless pickup and curbside to expand service to customers. And, our focus on the customer experience, beverage innovation and digital differentiates Starbucks and will enable us to regain the momentum we had prior to COVID-19. At Starbucks, the third place has always been about community, connection and convenience. And we expect to strengthen this competitive advantage through continued improvements in our digital capabilities and innovative store formats, enabling us to connect with customers and serve our community safely and with even greater convenience.

I am proud of how Starbucks partners in the US have shown up through all of this. The fact that while serving their communities, they also served over 1 million free cups of coffee to the frontline responders who have worked tirelessly to care for others, which makes us all very proud. Leveraging the playbook that was developed in China and refined in the US, we are working closely with our international license partners to navigate the current environment and prepare for recovery guided by our mission and values, and commitment to delivering the Starbucks Experience safely and responsibly. With Starbucks in 82 markets, we are committed to supporting our license partners around the world as they, too, navigate this challenge.

And, finally, a few comments on our Channel Development business. The strategic value of our Channel Development segment has been clearly evident in the current environment. Selling Starbucks products through multiple channels amplifies the brand and extends our ability to meet customers where they are, even when they are unable to visit our retail stores. Through the Global Coffee Alliance with Nestlé and our ready-to-drink partners, including Pepsi and Tingyi, we offer a wide range of Starbucks products down the aisle in grocery stores, at mass merchants, in convenience stores and online. In Q2, this segment's revenue grew by 16%, which includes a 5% favorable impact primarily related to the Global Coffee Alliance transition-related activity boosting our share of the coffee market outside of specialty retail. This continues to be an important element of our growth at scale agenda. The Global Coffee Alliance with Nestlé was established just 20 months ago, and since that time we have now expanded the Starbucks brand to nearly 50 markets around the world. It is clear that our channel strategy is working extremely well.

Before I hand over to Pat to walk you through the details of the quarter and balance of year perspective, I want to reinforce one key point, Starbucks is resilient. For over 49 years, since our founding, we have overcome every challenge presented to us, and are overcoming this challenge as well. Our China business is on a path to recovery. Our US business is entering the phase of reopening stores, adapting to the new reality and restoring and rebuilding momentum. And our Channel Development business is posting very strong results and acting as a brand amplifier. Our growth at scale agenda provides the focus and discipline for us to successfully navigate this challenge. We remain confident in our approach. We understand there is much more to do and that we must be agile as the world navigates COVID-19 and works to create a vaccine.

We have a very clear path going forward. We are optimistic about the future. And we believe Starbucks will emerge from this experience even stronger, more determined and more focused than ever before. But the real credit goes to Starbucks partners. Together, we are emotionally connected to a mission grounded in humanity, and together we are making principal decisions true to our values. Partners are the key to our resilience. It is why we will do all we can to provide them with economic certainty and support them through this challenging period. After all, partners are the heartbeat of Starbucks.

Now, I'll turn it over to Pat for a deeper dive into our Q2 financial results, an update on our FY 2020 outlook, and an overview of our financial readiness to weather this crisis. Pat?

Patrick J. Grismer

Executive Vice President & Chief Financial Officer, Starbucks Corp.

Thank you, Kevin, and good afternoon, everyone. I'd like to start by echoing Kevin's appreciation for all of our Starbucks partners who continue to demonstrate their dedication to Starbucks and their communities in spite of the hardships facing the global community right now. Unsurprisingly, business disruption attributable to the COVID-19 pandemic has materially impacted our financial results. Our belief is that these impacts are temporary, as evidenced by our continued recovery in China, as Kevin outlined, so I will highlight the financial impacts to provide investors with perspective on our normalized performance for the second quarter as well as insight into how future quarters' results may be affected by these conditions.

In all cases, we have estimated these impacts by comparing Q2 actual reported results to our internal forecasts, specific to each operating segment and market. These forecasts were developed based on the most recent prevailing trends in revenue and profitability prior to the onset of material COVID-19-related business impacts, specific to each operating segment and market. These impacts first started in China in late January and materialized in other markets later in the quarter. For the second quarter, Starbucks produced consolidated revenue of $6 billion, down 5% from the prior year. We estimate the COVID-19 impact to be approximately $915 million due to temporary store closures, restricted sales channels, shortened operating hours and severely reduced customer traffic.

As we shared earlier this month in an 8-K, Q2 non-GAAP EPS was $0.32, down 47% from the prior year. We estimate the COVID-19 impact to be approximately $0.45, including not only profit flow through on the revenue impact that I noted earlier, but also incremental costs that we incurred in response to the pandemic, which I will outline later. I will first provide some highlights of segment operating results and consolidated margin performance for Q2 and will then share some perspective on balance of year results and liquidity. Revenue for our Americas segment was flat in Q2 relative to the prior year at $4.3 billion, as incremental sales from net new store growth of 3% over the past 12 months was effectively offset by a 3% decline in comparable store sales.

Through the first 10 weeks of the quarter, the US delivered 8% comparable store sales growth, building on the strong momentum from the past few quarters. But this was more than offset by a sharp decline in the final three weeks of the quarter due to the COVID-19 impact that I mentioned earlier, ultimately resulting in a 3% decline for the quarter. We estimate Americas Q2 revenue decline attributable to COVID-19 to be approximately $450 million. Through the month of February, Americas non-GAAP operating margin improved meaningfully versus the prior year, reflecting strong sales leverage and continued supply chain efficiencies.

However, due to the rapid sales decline and significant investments in response to the COVID-19 outbreak that started to materialize in the US in mid-March, Americas Q2 non-GAAP operating margin landed at 14.4%, down from 20.3% in the prior year. We estimate that the COVID-19 impact to Americas non-GAAP operating income was approximately $420 million in Q2, consisting of flow-through on lost sales as well as incremental investments, notably catastrophe wages as well as enhanced pay and benefits programs in support of our retail store partners, inventory write-offs and store safety supplies.

Moving onto International. Business disruption resulting from COVID-19 impacted the segment for the majority of Q2, starting with China in late January and extending to other markets in March, including Japan. For the quarter, International's revenue declined by $395 million or 26% versus the prior year to $1.1 billion, primarily driven by a 31% decrease in comparable store sales, partially offset by 11% net new store growth over the past 12 months. We estimate International's Q2 revenue decline attributable to COVID-19 to be approximately $465 million. International's Q2 non-GAAP operating margin was 3.9%, down from 19.3% in the prior year. We estimate that the COVID-19 impact to International non-GAAP operating income was approximately $280 million in Q2, with components similar to what I outlined for the Americas. Further contributing to the margin decline was a higher than normal sales mix of delivery transactions as customers shifted to off-premise consumption resulting in higher commission and packaging costs.

Onto Channel Development, revenue was $519 million in Q2 fiscal 2020, an increase of 16% over the prior year. When normalizing for the 5% favorable impact of Global Coffee Alliance transition-related items, Channel Development's revenue grew 11% in Q2 over the prior year. Transition-related items include higher inventory sales as Nestlé prepared to fulfill food service customer orders under the Global Coffee Alliance, as well as a benefit related to the transfer of certain single-serve product activities to Nestlé on a go-forward basis. The segment's non-GAAP operating margin was 37.8%, an improvement of 360 basis points over the prior year, normalizing for the 330 basis-point impact of the transition activities I just mentioned. Channel Development's operating margin expanded 30 basis points in Q2.

Finally, at the consolidated level, non-GAAP operating margin of 9.2% in Q2 contracted 660 basis points year-over-year. We estimate the COVID-19 impact to non-GAAP operating income to be approximately $700 million, inclusive of the amounts I cited for the Americas and International. In relation to the $915 million of consolidated revenue impact that I mentioned earlier, this equates to approximately 80% of flow-through on lost revenue, which is materially higher than the 50% variable flow-through rate that we typically observe in our business, reflecting the significant investments we've made in the short term to support our partners and manage our brand for the long-term. We believe that these investments will strengthen our competitive position and fuel a recovery as we emerge from the effects of the pandemic.

Now moving onto our outlook for fiscal 2020. Given the global nature of our business, our ability to provide updated guidance for the remainder of the year is predicated on the current phase of COVID-19 response within each of our markets. As Kevin discussed, China, our second largest market, is in the recovery phase, which enhances our ability to estimate balance of year results. However, the US, Japan and Canada, which round out our fourth largest markets are in earlier phases of COVID-19 impact and response, which limits our ability to provide enterprise-level guidance at this time. As a result, we are continuing to suspend formal guidance for fiscal 2020 while providing updated outlooks for selected businesses and financial metrics.

I'll start with China. With the progress we have seen to date, including having 98% of our stores open as of today and continued improvements in customer traffic, as Kevin mentioned, we believe China's comparable store sales will continue to improve in the second half of fiscal 2020, relative to the 50% decline reported for Q2, declining 25% to 35% in Q3, and trending towards roughly flat by the end of Q4 relative to the prior year, yielding a decline of 15% to 25% in China's comparable sales for the full fiscal year. While we temporarily paused new store openings in China in Q2 given COVID-19, development activities resumed towards the end of the quarter, and we are on track to open at least 500 net new stores this fiscal year, or over 80% of our original target. This will position us well to continue to capture the growth opportunity we see in China in fiscal 2021 and beyond.

Combining the effects of comparable store sale declines and new store development deferrals, we estimate revenue in China to be negatively impacted by COVID-19 by approximately $750 million to $850 million, with an estimated EPS impact of between $0.30 and $0.37 in fiscal 2020, barring any new disruptions.

Moving to the US. Today, approximately 50% of our company-operated stores and 46% of our licensed stores in the US are temporarily closed. But we expect to begin reopening many of them next week, initially with modified operations and shorter operating hours. We currently expect approximately 90% of company-operated stores to be open by early June.

Additionally, modifications to increase throughput in drive-thru, delivery and MOP channels in our existing stores are already underway, along with a new entryway handoff solution which incorporates best-in-class safety protocols. And as Kevin mentioned, we are also exploring curbside service in locations where parking is available.

We believe the focused actions we are taking to deliver a contactless customer experience, coupled with continued beverage innovation and expanded digital capabilities, will help to restore the upward momentum in our US business that we were experiencing prior to the onset of COVID-19. To date in April, comparable sales growth for US company-operated stores that are open, is averaging approximately minus 25%. We're indexing at 75% of prior year levels. However, as we have not yet entered the recovery phase in the US, it is premature to provide a balance of year estimate of US revenue or earnings at this time.

But given the late quarter onset of COVID-19 impacts in the US, as well as a materially higher flow-through rate on lost sales in the US, we do expect the negative financial impacts of COVID-19 to be significantly greater in Q3 compared to Q2 and to extend into Q4. So while the initial impacts in the US are less severe than they were in China from a comparable store perspective, owing to the prevalence of our drive-thru model in the US, we do expect the impacts to persist for a longer period of time as we move through the monitor and adapt phase with the recovery phase extending into fiscal 2021.

We expect the COVID-19 impacts in Canada and Japan, as well as in our international license businesses, will follow a similar pattern as the US, very pronounced in the third quarter, with some easing of these impacts expected in the fourth quarter as these businesses move into the recovery phase. In any event, based on our substantial experience in China today, we continue to believe that these impacts are temporary, that our brand is resilient and that our business will fully recover over time.

At the enterprise level, we expect the absolute flow through impact of COVID-19 to be materially greater in Q3 compared to Q2, in particular, due to the longer duration of US, Canada and Japan business disruptions in Q3 compared to Q2. That said, we expect the rate of flow-through on lost sales in Q3 to be slightly lower than in Q2 and to ease further in Q4 as we take appropriate steps to restore the profitability of company-operated stores as they reopen in the back half of the year.

Consistent with the approach we have taken in our two interim updates this quarter, we will provide transparent updates as to what we are seeing and how that shapes our perspective on balance-of-year financial results as we execute our store reopening plan and have increased visibility into business performance trends in the US and other markets.

We expect to provide our next update in June, after we've evaluated the performance of stores reopened in the US and better understand the possible duration of temporary closures in Japan. From our perspective, the reopening of stores and actions we are taking to position ourselves when the crisis subsides do not fully define recovery. Recovery, in our view, is when a company-operated market delivers positive comparable store sales growth and all existing stores are open, with the exception of those undergoing renovation.

Finally, on a reported basis, Channel Development revenue is expected to decline between 6% and 8% in fiscal 2020, relative to the prior year as we lap certain transition items related to the Global Coffee Alliance that benefited the segment's top line growth in fiscal 2019, with the impact being more pronounced in Q3 and far less pronounced in Q4. Additionally, the disruption resulting from COVID-19 is expected to adversely impact food service under the Global Coffee Alliance and our ready-to-drink business during the balance of fiscal 2020. The segment's operating margin is expected to improve modestly in fiscal 2020 relative to the prior year.

The cash flow implications of these near-term operating results are very material. But the scale of our company, combined with the strength of our balance sheet, enables us to manage our business for long-term growth while dealing with short-term business realities. In essence, we are investing in relationships with key constituents not only to preserve those relationships but to strengthen them for the future. Let me provide several examples of how we are thinking about this.

First, there's salary and wage continuation and through premium pay for those working on the front lines of our business, both as communicated through the end of May, we are investing in our partners who are critical to the Starbucks Experience and instrumental to our long-term success. Second, by extending more flexible development and financial terms in Q3, we are investing in our international licensees, who are our partners in driving long-term growth. Third, through certain accelerated payments, we are helping strategic suppliers weather this crisis so that they can sustain the supply of our proprietary products and support our ongoing product innovation. And fourth, by honoring our upcoming quarterly dividend declaration, we are supporting our shareholders with a predictable return of capital in an uncertain investment environment. Our next dividend is payable on May 22 to shareholders of record on May 8.

As disclosed in our most recent 8-K, in addition to accessing additional capital to bridge near-term cash needs, which we expect to peak in Q3, we are creating additional room for investment in our partners and the business more broadly by suspending share repurchases, reducing discretionary expenses and deferring certain capital expenditures. Due primarily to the deferral of some new store openings and store refurbishments, we now expect capital expenditures for fiscal 2020 to total approximately $1.5 billion or $300 million lower than our original plan prior to the onset of COVID-19.

Importantly, we remain very much committed to our BBB+ credit rating and leverage cap of three times rent-adjusted EBITDA. That said, while the impacts of COVID-19 will cause us to exceed that leverage cap for a period of time, we view these impacts to be temporary. We expect our leverage to return to near three times rent-adjusted EBITDA in the latter part of fiscal 2021. In short, our leverage policy is unchanged.

To summarize: the financial impacts of COVID-19 are very material and will weigh on our Q3 performance in particular. But the progress we are making in China and the deliberate approach we are taking in the US to reopen stores, reinforce our belief these headwinds are temporary. We are confident that our brand is resilient and that our customers are eager to resume their daily routines. We have the financial strength to make investments for the long term as we navigate challenges in the short term. And we are inspired by the courageous partners who serve our communities by serving our customers at a time when people are looking for the personal connection that define the Starbucks brand.

And 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: [Operator Instructions] Your first question comes from the line of David Palmer with Evercore ISI. Please proceed with your question.

David Palmer
Analyst, Evercore ISI

Q

Thanks, and good evening. In the US, could you talk about your store base in terms of the percentages that are in what are not only closed today, those walk-in locations, but also areas that you would anticipate being slower to rebuild sales. Perhaps you want to use China as an analogy here but what I'm thinking about is the mall locations, those downtown areas, or even drive-thrus that depend on commuting and highway travel. Any numbers against this, that would be helpful as we think about your path to recovery. And relatedly, how much do you think social distancing in these walk-in stores will limit your capacity when they do reopen? Thanks very much?

Kevin Johnson
President, Chief Executive Officer & Director, Starbucks Corp.

A

Thanks David. Roz, why don't I let you share a little bit of perspective on the US?

Rosalind Gates Brewer
Chief Operating Officer, Group President & Director, Starbucks Corp.

A

Thank you, Kevin, and thank you, David, for that question. Let me first start off talking about April. So to date in April, we did have drive-thru locations open. And as Pat mentioned, we had comparable sales growth in those US company-operated stores averaging down by about 25% or indexing right at about 75% of prior levels. So as we reopen stores, we did a few things to really create the analysis. We created a decision modeling tool that helped us look at the customer frequency that we saw in those drive-thru stores, as well as looking at sources from local government guidance, the infection curves by county, customer sentiment and partner sentiment.

So when we open starting next week, we're going to open with modification. And those modifications will be drive-thru stores. We will amplify delivery. We will have mobile order-and-pay channels open and then the addition of a new concept, the entryway handoff. We will only have roughly 30 stores that will be cafe open-and-order. And in those 30 stores, there will be no seating.

So we are making sure that we provide a safe environment for our customers and for our partners, and we will monitor what happens as shelter-in is lifted in certain regions and areas and then begin to reopen the cafe stores. You'll see later in the summer, we'll also add curbside access to our stores. So what we're doing, David, is managing what we're learning and then opening the stores accordingly and applying our partners and our labor against these new entryway models and also to amplify drive-thru. We'll also be helping our customers use the app and make sure they order ahead and pickup in store, either through drive-thru or those other channels that I described.

Kevin Johnson
President, Chief Executive Officer & Director, Starbucks Corp.

A

Thanks, Roz. I'll just add one other point that was shared, David, to reinforce what Roz just said. Pre-COVID, 80% of our customer occasions in stores in US were for to-go, takeaway. And so by augmenting the in-store experience with mobile ordering and contactless pickup, we can serve a significant volume of customers without having the cafe seating area actually opened.

And so I think that's an important point. Areas that will be slower are similar in China. If it's stores near office parks, where office workers are not going back to work yet, they'll be a little slower. And then I think we anticipate that the mall stores will also be slower and that mall stores are fewer than 8%, I think, of the total store fleet in the US. But I think Roz captured it quite well.

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

John Ivankoe

Analyst, JPMorgan Securities LLC

Q

Hi. Thank you very much. I wanted to follow up on the China piece of the – in terms of the percent of occasions to go that are within China. I mean, I think you've said a couple times now, 80% of the occasions are to go in the US. I would expect that number to be much lower than that in China but help in clarify that. Starbucks really does differentiate itself with the cafe experience and the third-place experience. So can you, kind of, I guess, triangulate the percentage of transactions that are to-go? In China, with the thought that you might actually get to somewhere near flat comps at the end of the fourth quarter, how you can do that without basically a full reduction of physical social distancing within that market specifically? And thank you. And hope everyone is well.

John Culver

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

A

Okay. Thank you, John. Appreciate that. Just real quick, on China, traditionally, we've seen 80% of our business be stay-in and enjoy their drinks in the cafes. As COVID hit, we hit a peak of nearly 80% of transactions being digital orders. Those digital orders were all set up with the contactless experience through walking in the stores and picking up your orders in mobile order-and-pay and then the rest of it was delivery.

What we see today is that in the stores that we have opened, we have roughly 83% of those stores have seating in them with social distancing in place. And so we are seeing people come back into the cafes and sit there albeit not to the levels that we saw pre-COVID. What we're seeing is that there is a higher percentage of to-go orders taking place in China and we expect that trend to continue.

And if there is a silver lining, I think it is forming a new habit in China where you are seeing more people take to-go orders and get used to doing that. And so we're optimistic that the shift will continue to occur. We anticipate the 80% of where we were pre-COVID will come back, maybe not as high, but the overall sales levels that we see in China, we will get back to full recovery and on a path to full recovery by the end of this fiscal year.

Kevin Johnson

President, Chief Executive Officer & Director, Starbucks Corp.

A

Thanks John. Let me just add one other observation. When we look at consumer behavior on a global basis as it relates to COVID-19, after people have been sheltering at-home in a lockdown situation for several weeks, in China, it was a little over three weeks, in US it's been about six weeks. What they look for, what consumer sentiment looks for is something that is safe, experiences that are safe, familiar and convenient and that is consistent around the world. And so, what we've done at Starbucks is we've built the operating protocols in our stores to be safe, to follow every – and exceed every health standard we can exceed and ensure we can provide every customer a safe experience.

Clearly, getting that Starbucks Experience is something that's familiar to them. And when you've had to be sheltering in place for several weeks, just to get out for a nice uplifting experience at Starbucks, it's familiar and it's rewarding. And so, customers come back to our stores but having this convenient ability and those three attributes, safe, familiar and convenient, that is something that works around the world following these periods where people have been sheltering at-home.

We've seen that in China and I think we're going to see that in even a more amplified way in the US but it's something that we're seeing in every single market around the world when they come out of sort of the lockdown phase.

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

Sharon Zackfia
Analyst, William Blair & Company, L.L.C.

Q

Hi. Good afternoon. Could you talk about how your digital trends have kind of ramped as you've gone through April? I know you gave the update on rewards for the second quarter. It would be helpful to know what you're seeing with engagement as we've gone through this month. And then can you also give us an update on, kind of, any initiatives you have on communicating safety protocols as you start to reopen more of the in-room dining?

Kevin Johnson
President, Chief Executive Officer & Director, Starbucks Corp.

A

Roz, why don't I have you kind of respond as it relates to digital in US and safety protocols? And then maybe John can follow-up on the China digital. So why don't you go ahead first, Roz?

Rosalind Gates Brewer
Chief Operating Officer, Group President & Director, Starbucks Corp.

A

Sure. So as Kevin mentioned, when we started off the call, we saw as we were entering the quarter and actually exiting last year, our reward members, which are highly routinized customers have really grown with us. We've increased to over 19 million of those customers in the US, up 15% a year ago. One of the things that we're seeing as we've been going through this COVID experience is our Starbucks Rewards members, they remain roughly 44% of our business, even as we progress through the quarter. And the majority, roughly about 70% of them, are frequent Starbucks Rewards customers. And they're still coming to our stores, just less frequently. So, and also, to think about what that looks like over a daytime, really, we've not seen much change there. There's same frequency loss across all dayparts. It's a little bit more pronounced in the morning but that's to be expected because the routines have been disrupted.

So we are encouraged by what we've seen so far in the US. We believe that these highly resilient customers will come back to us. The routines may look a little bit different as people remain in a work-from-home position, but even as local mandates get relaxed, we feel like we can monitor and adapt accordingly.

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

A

And just real quick, Sharon, on China. We continue to see digital being a key element of our strategy in China. And, really, the adoption of the digital transactions in our stores continues to accelerate. What we've been able to do is leverage our Starbucks Rewards membership to really maintain that connection and engagement during the COVID experience. We're seeing sequential improvements in overall weekly active members. So more and more people continue to adopt the digital app and interact with us digitally. And as I shared, or was shared in one of the scripts, digital order mix is now 29% in Q2. We had a peak in early February of 80% early on. And, really, you're seeing a good split between mobile order-and-pay making up about 16% of that 29% and delivery making up about 13%. So we're very encouraged with the opportunity in digital.

And now, just a couple days ago, we announced our partnership with Sequoia Capital, which we think will further accelerate our ability to leverage the digital flywheel and accelerate the pace of retail innovation as we look to partner with local tech companies and key start-ups in China.

Rosalind Gates Brewer
Chief Operating Officer, Group President & Director, Starbucks Corp.

A

Sharon, you had a second part of that question? I'd like to address the second part of Sharon's question. She also asked about the marketing piece around the US business. And we do have a marketing plan scheduled as we reopen next week. And actually, if you think about the shutdowns that we had, we delayed the introduction of our spring beverage lineup and Double-Star Days in addition to our happy hour. So you'll see those reignited with a lot more energy than in past.

We will spend within our existing plans for this year, just condense them and accelerate most of the work around enabling our app and encouraging people to use the app and order ahead. And then in terms of delivery, we've been able to accelerate in delivery we believe in some markets like New York where we will have a handful of delivery-only stores. We're seeing some significantly higher volumes than normal with delivery in places like New York. But it's still early for us for delivery overall but it is one of the channels that we will accelerate as we go through the post-COVID and COVID recovery period.

Sharon Zackfia
Analyst, William Blair & Company, L.L.C.

Q

Thank you.

Operator: Your next question comes from John Glass with Morgan Stanley. Please proceed with your question.

John Glass
Analyst, Morgan Stanley & Co. LLC

Q

Thanks very much. My question is on how you think about the pace of the US recovery. In addition, obviously, due to the pandemic, we're in a recession. So how do you think about incenting customers to come back differently? Or is that not in your calculus? You believe once stores are open, consumers will resume their normal pace of consumption. Have you thought about like the product lineup differently now because of this situation? And maybe if you're using China as a benchmark, are consumer behaviors different? Are they purchasing different? Are they more price sensitive in China? Or have you really seen no post-pandemic or – once you reopened, price sensitivities in China?

Kevin Johnson
President, Chief Executive Officer & Director, Starbucks Corp.

A

Yeah, John, this is Kevin. Let me just comment. Pre-COVID, we had built tremendous momentum in the business by focusing on three things: the customer experience, beverage innovation and digital customer relationships. And that remains the powerful combination for us to continue to engage and drive frequency of customer visits. But we recognized coming through the COVID experience that everyone around the world is sharing that really optimizing the initial store experience around these concepts of safe, familiar and convenient is what gets customers now to start – that's kind of the onramp to that engagement.

Now certainly, we're going to know a lot more 30 days from now in the US. But I think as Roz highlighted that in the drive-thrus, just the number of drive-thrus we've had open, without even the cafe open, we were delivering roughly 75% of prior-year revenue in those individual stores. And so that's just an indication of the power of the brand and the strength of connection that we have with customers. Now, I think as over this next week when we open more stores and with the set of experiences that Roz has articulated, I think we're going to begin that path of engaging. And I think 30 days from now, we're going have a much clearer view of how rapidly that goes. And we got a great beverage lineup that Roz just talked about that's going to release. We're going to market and evangelize that. We just grew digital customer relationships by 15% to 19.4 million in the US. We're going to leverage that to communicate with our customers. And we're going to be thoughtful and responsible with each step that we take. And I think that's the formula.

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

Sara Harkavy Senatore
Analyst, Sanford C Bernstein & Co., LLC

Q

Hi. Thank you. Just a follow up on the US. I guess I was surprised at how strong the ticket growth was. I apologize if you talked about this. But is that sort of an offset to the impact on traffic from the COVID pandemic? We've heard from some other concepts that higher checks are happening because there's more group ordering, or were there other drivers when I think about menu innovation or sort of more sustainable drivers? And as you reopen stores in the US, do you have any sense of how much of those volumes in the stores that remained open might have sales transfer from closed stores? Just trying to figure out, as you open stores what the sort of system-wide sales will look like. Should we just think about kind of doubling the number of stores that are open and doubling the sales volume, or is there some transfer that's been happening? Thanks.

Kevin Johnson
President, Chief Executive Officer & Director, Starbucks Corp.

A

Roz, why don't you take those questions?

Rosalind Gates Brewer
Chief Operating Officer, Group President & Director, Starbucks Corp.

A

Sure. Thank you, Sara, for the questions. First of all, let me start with – so the plan, we'll start reopening stores next week, and then with the anticipation that we'll have just a little greater than 90% June 1 in the various formats. Sara, when I think about the trend in both ticket and traffic, I think about the exit of fourth quarter into first quarter where we were seeing great pick up in terms of our beverage innovation, most predominantly in Nitro, Cold Brew and all cold coffee selling extremely well. It played well through our holiday beverage lineup, and it continued to the point where we saw the 8% comp just into early March, the first 10 weeks of the year. So first of all, it starts with our beverage innovation. The second thing is the in-store experience. And so we had done a significant amount of work to actually relieve the partner of a lot of their tactics they were doing in the stores, and they were engaging with our customers in some of the most meaningful ways, creating the best moments with our customers was really a real key change for us.

Our customer sentiment and customer engagement numbers were at record levels, in addition to our partner engagement was at record levels as well. We actually saw that partner engagement carry over to when we began to slow down stores due to COVID. We saw partners just volunteering to come work at stores, very energetic. The response from customers has been great. We've seen great social media placement from our customers concerning how grateful they were and what they recognize our partners are doing to work in the stores. So I would just take it back to, Sara, the work that we've been working on for quite a while now and it's around the beverage innovation, the digital engagements that we've created, and then the in-store experience. And those things continue to drive, and that is exactly where we got to the 8% comp as we were coming into the COVID situation.

Kevin Johnson
President, Chief Executive Officer & Director, Starbucks Corp.

A

Yeah. I'll just add, the increase in ticket was group orders. I mean, with drive-thrus – going through a drive-thru, it's typically someone making a family Starbucks run and buying for their entire family or somebody making, let's say, a frontline responder run and buying – getting food and beverage for frontline responders. We saw a lot of that. So it was really driven by the fact it was just drive-thru only. And if you're going to take the time to go through drive-thru, you're going to load up and buy for the entire family or the entire group, and that drove down transaction, drove up ticket.

Operator: Your next question comes from the line of David Tarantino of R. W. Baird. Please proceed with your question.

David E. Tarantino
Analyst, Robert W. Baird & Co., Inc.

Q

Hi. Good afternoon. I hope everyone's doing well. Pat, my question is about the level of potential cash burn you might have in the current quarter. I was wondering if you could maybe frame that up for us. And then just talk about your commitment to maintaining the dividend throughout this crisis. I think you mentioned that there's no plans to suspend it. But just wondering what your margin of safety is relative to that question. And then I guess thirdly, at what point would you feel comfortable as the CFO ramping back up the capital spending with respect to growth and other discretionary CapEx? Thanks.

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

A

Thank you, David. I'll start off by saying that given the scale of our company combined with the strength of our balance sheet, we are confident that we will be able to maintain appropriate liquidity as we manage the current crisis. Now, when you consider that today over 50% of our company-operated stores are closed in the US and Canada, and those that are open are largely restricted to drive-thru and delivery channels, and with store partner payroll protection temporarily in place, our cash burn rate has peaked. And it's at approximately $125 million per week after CapEx but before our dividends. We expect this burn rate to go down as we begin reopening large numbers of company-operated stores in the US and Canada in the month of May and to reduce further in the month of June as we normalize our store partner pay practices and benefits from recapturing sales.

We have already taken steps to enhance our financial flexibility, and that includes issuing $1.75 billion of bonds in March with the proceeds used to pay down outstanding commercial paper balances, temporarily suspending our share repurchase program, deferring certain capital expenditures and reducing discretionary spending. And so with the amount of cash currently available to us, and that includes our existing credit facilities and additional borrowing capacity if we need it, we're comfortable with our overall liquidity position. And we're well prepared to manage current operating conditions from a cash flow perspective. And that includes the investments in interim partner wages and benefits which we have extended through the end of May. That said, our near-term focus clearly is on reopening our stores and optimizing their profitability as we emerge from the crisis and learn more about underlying customer traffic patterns and trends.

Now, you asked about our dividend. As I said in my prepared remarks, one of the things that we're proud of is that we're able to maintain our commitment to shareholders, to provide some measure of certain return in an uncertain investment environment. So our intention today is to continue to pay our quarterly dividend. As to CapEx, we've already taken steps to trim CapEx this year. That includes the deferral of certain new store openings that were planned for this year, deferring those into next year. That includes, for example, China, where we had originally guided to 600 new stores this year. We've taken that down to at least 500. So there is some deferral of capital associated with that, and we've taken the opportunity to trim some of our other capital spending programs, including store refurbishments.

But based on what we see today, including our expectation that sales will start to recover as we come out of the third quarter into the fourth quarter into next year, I would say at this stage, we would expect CapEx to normalize in fiscal 2021. But it's simply too early to give any specific guidance around CapEx. But I would say that we're optimistic that given the shape of the recovery curve going into next year that our capital spending programs, which underpin so much of our growth, we would expect to normalize next year.

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. Pat, question for you in terms of the outlook, at least for the second half. I know it's tough to offer global second half guidance. But you have given us some April color, so I believe US down 25%, China down 35%, and we can obviously estimate the path to comp recovery, in fact you were very specific on the China path. So with all of that said, how do we think about it from a reasonable operating margin range in the US and China based on these current comp trends or, I don't know if you're more comfortable to give kind of the sensitivity, the annual benefit to earnings from points of comp or base points of margin? Just trying to make sure there aren't any outliers in terms of rest of year 2020 or 2021 modeling. I don't know, any form of sensitivity or framework you can provide in terms of what the type of down comp you're talking about would imply for operating margins in those two big segments over the next couple of quarters. Thank you.

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

Thank you, Jeff. Well, current margin performance is obviously highly distorted by large levels of store closures and interim store partner pay practices. So talking about the value of incremental comp growth or incremental margin improvement is somewhat irrelevant, I would say, at this juncture. Our top priority and our near-term goal is to return to cash positive store operations and to improve from there towards full recovery. And we will do that by reopening large number of stores and improving our profitability, including normalizing store partner pay practices starting in May. And based on our current store reopening plans, we expect that our cash needs are going to peak this quarter.

Now, as I said in my prepared remarks, we do expect the absolute impact of the lower sales and increased investments to intensify in the third quarter. It will be much more significant than they were in the second quarter, in large part given to the longer duration of impact. Because when you think about it, and let's talk about the US business, in the second quarter, we had between two and three weeks impacted by COVID-19 outbreak. In the third quarter, for all intents and purposes, we're expecting 13 weeks of impact, most significant in the month of April, but reduced in the months of May and June as we reopen our stores and normalize our pay practices.

Now, for International, it's slightly different in the sense that we expect continued improvements in China from both the sales and margin perspective. But we do expect adverse impacts in Japan and other markets, including EMEA, to intensify compared to Q2. And that's, again, largely due to an extended duration of impact in the third quarter. On balance, there's just too many unknowns and too many moving pieces to be able to provide more explicit guidance on Q3 results outside of China at this time, other than to say that the impacts to revenue and to operating income will be much more substantial in absolute terms in Q3 compared to Q2. But we do expect these impacts to moderate in the fourth quarter. And we will continue our practice of providing updates to the investment community when we have better visibility to them.

Operator: Your next question comes from the line of Dennis Geiger with UBS. Please proceed with your question.

Dennis Geiger
Analyst, UBS Securities LLC

Q

Great. Thanks for the question. Just wondering if you could talk a bit more about the competitive environment both in the US and in China, and how the Starbucks brand is positioned coming out of this – certainly depending on the situation with smaller chains and the independents, or even the larger chains in the case of China. Just what that might mean for customer demand, for your traffic trends and also site selection and longer-term development potentially? Thank you.

Kevin Johnson
President, Chief Executive Officer & Director, Starbucks Corp.

A

Yeah, Dennis. This is Kevin. I would just start by commenting on the momentum that we had generated pre-COVID. And clearly, posting an 8% comp with four points of transaction growth in the US in the first up until the last two weeks of March, was clearly an indication that I think this combination of the in-store experience, beverage innovation and digital customer relationships was putting us in a position where we were, I think, growing share of the customer occasions at specialty coffee retail. And I believe, if anything, the way we've navigated the virus continues to put us in a very strong position competitively. That said, there's the economic implications following this sort of yet to be determined. I think we're very optimistic about our competitive position, and we'll be a lot smarter 30 days from now after we get to see the reaction of the reopening in the United States. Similarly in China, I think we're also in a very strong competitive position.

I'd say both in the US and China, we're in the strongest competitive position that we've been in, in the history of the company. And a lot of that comes through the focus and discipline that we had going into COVID as well as the principal way we have decided every action we've taken to navigate the COVID virus responsibly and thoughtfully, prioritizing the health and well-being of our partners and our customers, the engagement partnership we've had with governments and health officials to help contain and mitigate contain the spread of the virus. And the fact that we are showing up in a positive and responsible way in every community that we're a part of. And so I think our competitive position is very strong. That said, we rise, we've got to stay focused on the things that matter. We've got to do the right things for our partners and our customers. And if we do that, I think we emerge from this strengthening the brand and strengthening the connection that we have with our customers.

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. If we look at kind of the comp numbers in the US business that you discussed in March and then your guidance for April, overall, it might suggest that there hasn't really been a big sequential or week-on-week improvement in the business. And with the rest of restaurant, most of them are showing kind of week-on-week improvement. So I'm wondering when you drill down a little bit on the weekly trend, are you starting to see improvements here with consumers or do you need to see these new initiatives like curbside or store reopenings before comps can reaccelerate? Thank you.

Kevin Johnson
President, Chief Executive Officer & Director, Starbucks Corp.
A

Pat, why don't you take the numbers on the comp, and then we'll hand off to Roz to talk about sort of the trends that she's watching in terms of customer behavior?

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

Certainly. Thank you, Katherine. So since the third week of March when we initiated widespread closures of stores in the US, we've seen the comps which include the impact of closures based on how we defined comps for this period of time as being fairly steady in the range of minus 60% to minus 70% as we have in recent weeks reopened some more of our drive-thru stores, we've seen slight improvement within that range so that we're closer to the minus 60% end of that range. But it really is not until we begin to reopen large numbers of stores starting the week of May 4th that we would anticipate seeing a material improvement in that number.

Kevin Johnson
President, Chief Executive Officer & Director, Starbucks Corp.
A

Yes, more stores and more ways for customers to engage. And so Roz, why don't you talk a little bit about sort of the incremental ways that we're now engaging beyond just drive-thru as we reopen these stores next week?

Rosalind Gates Brewer
Chief Operating Officer, Group President & Director, Starbucks Corp.
A

Yes. So Katherine, thanks for the question. So first of all, Pat did allude to a range, so that 65% to 75%, so as you drill down just probably some of those stores that are doing better and we're seeing it migrate, it really depends on those local jurisdictions and where the sheltering in has been lifted, and we're seeing that over the last week or so. So in some instances it's actually too early to tell. Also, remember that we have really turned off any marketing in this time. And so our customers are used to us introducing spring beverage, in addition to speaking to them on a one-to-one basis through our digital relationships, and we've not acknowledged our birthday presentations to our customers, we've not introduced happy hour, nor have we done our Double-Star Days. So I would say that we're operating in an abnormal position in terms of how we communicate to our customers.

Now coming out of the gate, we're doing a lot of new things with marketing. We'll have digital media, we'll have TV, we'll have paid social-owned earned media. That all begins early next week. We're also creating new email contacts to each one of our members. So those 30 million that we can reach, we will do that in the next week. And the most important thing is to let them know that we are open. And it's surprising to us in some areas people are not aware if we're open or not. And we've actually had different hours in different regions. So it's too soon to tell in terms of where the pickup will be. But we're pretty positive about the work that we have ahead of us and reintroducing our summer beverage line. So we're encouraged by that. I'll also mention, too, we have extensive work going on with our delivery partner. And so you'll see some marketing in the delivery space as well. So this acceleration of these new models that we opened, we're going to talk about them pretty broadly and mildly. And we'll know more over the next 30 days.

Katherine Fogertey
Analyst, Goldman Sachs & Co. LLC

Q

Thank you.

Operator: Your next question comes from the line of Brian Bittner with Oppenheimer. Please proceed with your question.

Brian Bittner
Analyst, Oppenheimer & Co., Inc.

Q

Thanks. Thanks for the question. In China, you're expecting same store sales down 25% to 35% in your third quarter. And Yum China this afternoon said the same quarter their comps are down roughly 10% thus far. What do you think is driving the lag in your recovery versus a peer like this just based on your knowledge of the market? Is it about coffee in general? And just in general, do you expect a similar lag in your recovery in the US as you reopen just given your dependency on employment levels and your dependency on habitual high frequency levels? Should we expect a similar like lag in the recovery? Thanks.

Kevin Johnson
President, Chief Executive Officer & Director, Starbucks Corp.

A

John, I'll let you comment on China.

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

A

Yeah, Brian, the biggest impact to us on the recovery is getting the rest of our stores open that aren't open. And those stores right now are in some of our highest volume channels, those being the international travel hubs and the airports, the tourist areas as tourism has subsided in China. And then, obviously, some of the entertainment areas in the downtown urban areas and in the neighborhoods. So once we get those stores reopened, we feel that we can get back to a path where our comps will continue to accelerate beyond what we're already seeing. The good news is, is that we continue to see transactions gain momentum in the market, number one. Number two, we also see digital continuing to play a bigger role, and in particular, MOP and MOD, and we're going to continue to leverage that.

And then, number 3, obviously, we're excited about getting new stores reopened as well and start opening new stores. And we're on a path where we are going to hit the 500 stores by the end of this year. And we are going to continue to accelerate what we've seen thus far in the month of April; we've opened seven new stores. They're performing well. We are also opening Starbucks Now, which is a mobile order pickup and mobile order delivery store concept. We now have it down in Shenzhen as well as in Beijing. We're going to continue to accelerate that concept. And once schools go back into session, which they start later this week and into next week, we foresee that the mornings will continue to recover as people go back into offices and get more back into routinized behaviors, which I think will help as well.

Operator: Your next question comes from the line of Andrew Charles with Cowen. Please proceed with your question.

Andrew Charles
Analyst, Cowen and Company

Q

Great. Thanks very much for the transparency. And I hope you're all staying safe. I was looking to get an update on supply chain, particularly on coffee, and to a lesser degree, pork. You guys are somewhat insulated from protein challenges and shortages that are starting to surface. But given the amount of coffee that is imported, and Latin America is a little bit earlier stages with COVID-19 relative to the US, can you talk about the visibility you have into securing the supply of coffee, and to a lesser degree, pork for breakfast sandwiches?

Kevin Johnson
President, Chief Executive Officer & Director, Starbucks Corp.

A

John, maybe you take green coffee sourcing. And then, Roz, why don't you take rest of supply chain, the roasting network as well as the food sourcing? But John, since you manage the coffee piece on green coffee, sourcing of green coffee, why don't you talk a little bit about that?

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

A

Yeah, Andrew, this is something that we're monitoring, obviously, each and every day. We feel very good with our positions on green coffee inventories and how we're positioned in the marketplace. What we've seen in terms of green coffee is that, in Latin America they're through the harvest and we were able to secure the adequate supply that we need. We're now moving into South America, into Brazil and Colombia, and we're continuing to see those markets have good crops this year. And we don't anticipate any supply disruption in that regard. So we feel good about the green coffee, and then as we get it here to the States, having the transportation setup to do so.

Rosalind Gates Brewer
Chief Operating Officer, Group President & Director, Starbucks Corp.

A

Thank you, John. Andrew, a couple of things on our roasting capacity. We've been able to keep our roasting facilities open and running. We have followed local mandates for closure as you can imagine in Amsterdam and different areas we shut down for a period of time. But we had a network of coffee built into the system. We did go take a few units down to do cleaning procedures, to make sure we had a safe environment. We've adjusted in our roasting facilities for social distancing and that's been very effective for us. It has not impacted our production capacity. So we feel pretty confident in our roasting capacity right now even before stores are opening. We are in good shape. In terms of food sourcing, there's a lot of activity happening in proteins. Our breakfast sandwich business is secure. I will talk a little bit about breakfast as a category that we are intentionally wanting to regain as we reopen. We feel confident that we've got the inventory there and have been in close contact with all of our suppliers in that area. So right now we feel pretty good about our position. Thanks for the question.

Operator: Your next question comes from Matt DiFrisco with Guggenheim. Please proceed with your question.

Matthew DiFrisco
Analyst, Guggenheim Securities LLC

Q

Thank you. Pat, my question is with respect to sort of the US stores and the 50% or so that are closed. Obviously, that's a higher number than a lot of your peers, and that would suggest that those stores or those locations are somewhat hamstrung during the COVID situation of being locked down. I would presume that you're going to expect those not to open up at 75% indexing pre-COVID May 1, as those probably were closed for reasons and employment not being back. Is that correct sort of an assumption, but also, is there some leverage you have potentially with renegotiating rents or leases on some of these stores that if the new normal looks a little bit as far as the recovery period, where they might be permanently hamstrung, is there some level of renegotiating or leases where since you've closed these 50%, that's given you a little bit of an entrance into that with the landlords?

Kevin Johnson
President, Chief Executive Officer & Director, Starbucks Corp.
A

Matt, this is Kevin. Let me just comment on the part of your question, then I'll hand it over to Pat. You suggested that 50% of the stores that we closed were hampered for some reason. That's not the case. We decided when we went into this shelter-at-home to only open drive-thrus, and we did that for partner safety. We just decided rather than have any location that has a cafe open during the period where the nation was sheltering at-home and social distancing, we thought that was the safest way for us to ensure both our partner safety as well as that of our customers. So that's what drove the decision to close all those stores. Whereas certainly others made different decisions and that's fine. But we prioritized the health and well-being of our Starbucks partners and the customers which is why we were more aggressive perhaps than others in closing stores. And then I'll hand over to Pat for comments on the rest of your questions.

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

Thank you, Kevin, and thanks, Matt, for the question. So a couple of things I'll comment on. The first is that as we reopen our stores that are currently closed, we will be applying our normal discipline to optimize store performance. We have a world-class operations team that is focused on the bottom line as on the top line, driving sales. So once we have better visibility to the sales recovery curves for those stores, we will be taking appropriate steps to optimize their profitability. Specifically, with respect to rent, what I'd like to say is that, to date we're quite proud of the fact that we have remained current on all of our rent payments which we believe reinforces our position as a developer of choice, if you will. We are having ongoing conversations with our landlords in various markets regarding what may be commercially reasonable lease concessions in the current environment. So we've not yet confirmed those arrangements and it's really premature to indicate what that relief may look like. But it is something that we are pursuing.

Kevin Johnson
President, Chief Executive Officer & Director, Starbucks Corp.
A

And I do think it is fair to believe that occupancy, lease rates are going to go down post-COVID just given the situation. And I think that's a fair assumption.

Operator: Your next question comes from Chris O'Cull with Stifel. Please proceed with your question.

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

Thanks. Good afternoon. Could you describe the primary differences and maybe the approach to reopening in the US compared to China? I'm just wondering if it will be easier to recover sales in one country more so than the other because of either the approach the country is taking to reopening or maybe because of just differences in consumer behavior?

Kevin Johnson
President, Chief Executive Officer & Director, Starbucks Corp.
A

Yeah, let me just comment briefly, and then I'll hand off to Roz to sort of share the path for US, and then John can close by a little bit of some of the differences in China. For me, I think the comment I would make was, in China decisions were made centrally by central government on a city by city basis, and even certain office parks and things were actually coordinated when they opened. And so the opening of stores was over a longer period of time than I think we're going to see in the US, but it was orchestrated city by city and almost community by community centrally. Keep in mind, in China, the period of shutdown or the period of sheltering at home was about three weeks, whereas here in the US it's been about six weeks.

And so now as we reopen in the US I think we anticipate that the stores are going to reopen across the nation at a faster rate, but the format we're going to use in each store is going be dependent on sort of what's happening in that particular store. So I think there's a lot of similarities in terms of the safety protocol, the operating protocols in the stores, the way we – the priorities, the principles we use to make these decisions. But I think there will be a little bit of a difference in terms of in the US deciding – we'll open them faster, but we'll decide geography by geography what's the appropriate format. Roz, why don't you share a little bit more about the plans that you see unfolding over the next 30 days?

Rosalind Gates Brewer
Chief Operating Officer, Group President & Director, Starbucks Corp.

A

Sure. So Chris, thank you for that question. So one of the things I'll highlight, and John Culver alluded to it earlier, is a different habit between China and the US. China is a sit-down market and the US is a grab-and-go market. So for us to have access to a good percentage number, more than 50% of our stores in the US are drive-thrus. So that alone is going to create a difference. The second difference I will say, and I think it's really obvious is that, we have this decentralized decision-making. And so local municipalities can make a decision on openings and closings and shelter-ins and not and the mobility of the customer. So we'll learn those patterns through the month of May and be able to come back to you, as Pat described, in early June.

But one of the things we're doing, and it's primary to us, is partner safety. And so as we reopen the stores, we're reopening in a safe environment, which is why these new modes of pickup and go were really enforcing. We're enforcing to download the app and pickup and order ahead. We're also providing the safety for our partners, things like a partner precheck. And we instituted that last week where thermometers will be available in all stores, and then we will actually have every partner take their temperature and then validate if they're ready to work through a series of questions. So that's something that we learned from China, it was very helpful for us. And so we learned from China and then just expanded that work and then looked at government and local health officials and what they were saying, and that's how we plan to open.

And we'll be in a safe position until we learn more. So we're going to learn as we go, as Kevin calls it, monitor and adapt. We're falling into line there and really going to open our stores. I'm encouraged that we'll have 90% of the stores open. The other thing I'll tell you is that our partners are really wanting to – they start from connection also. So they're excited about rejoining the stores next week, and we're having somewhat of a homecoming celebration for them as they reenter the stores next week, and actually take them through new training around the cleaning protocols and then also how to keep themselves safe and healthy, and how to keep customers safe and healthy. So we've got a pretty strong reopening plan that kicks off early next week.

Kevin Johnson
President, Chief Executive Officer & Director, Starbucks Corp.

A

Thanks, Roz. And John, last word on China.

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

A

Yeah, Chris. Just real quick on China. I think the big difference for us has been our ability to leverage the relationships that we've been able to build with the government officials, both in the central government, the provincial government and then into the cities. And really taking those relationships, being able to understand how they're thinking about the reopening, and working closely with them on staging our reopening based on what their plans were. We also were very well connected into the local health officials as well. And we worked very closely with them to put together the safety protocols in our stores and how we would operate our stores going forward. So really, making sure that we created a safe environment and that we continue to build on the trust that our brand has with our customers and obviously, with our partners.

And so what we've seen as we've opened up, first off, our partners, similar to the US we're very excited to get back into stores. And as a matter of fact, since we've begun and gotten to the 98% of stores reopened, our customer experience scores has actually increased by over 8 points pre-COVID levels. So the engagement level of our customers, and more importantly the engagement level of our partners is really amplifying the strength of our brand and the resilience of Starbucks in the market. So very proud of the work that they've done. And just want to recognize the China team for what they've done to navigate this complex situation.

Operator: Ladies and gentlemen, that was our last question today. I will now turn the call over to Mr. Kevin Johnson.

Kevin Johnson

President, Chief Executive Officer & Director, Starbucks Corp.

Thank you. I want to thank you for joining us today. And I hope you and your families are all safe and healthy. We continue to navigate through this unprecedented situation, staying true to our mission and values, and I'm pleased with where we are. China has demonstrated clear path to recovery. The US is prepared to reopen a large number of stores next week and throughout the month of May. Our Channel business has demonstrated resilience through all of this. And I am confident in our approach and optimistic about our ability to continue to drive Starbucks recovery in this monitor and adapt phase. We all understand the power of the Starbucks brand is strong. And through our principled actions, we have strengthened the trust and confidence that both our partners and our customers have in Starbucks. That will serve us very well for the long term. I'm very proud of how Starbucks partners have shown up in every part of the world. And we will continue to be focused, disciplined and transparent with all stakeholders as we continue to navigate this situation. Thank you.

Operator: This concludes Starbucks Coffee Company's Second Quarter Fiscal Year 2020 Conference Call. You may now disconnect.