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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 Third 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 third 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.

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, we estimate the impact of COVID-19 by comparing actual results to our previous forecasts. 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 to 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. For certain non-GAAP financial measures mentioned in today's call, please refer to our website at investor.starbucks.com to find the corresponding GAAP measures as well as a reconciliation of these non-GAAP financial measures 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, August 28, 2020.

Finally, for your calendar planning purposes, please note that our fourth quarter and fiscal year 2020 earnings conference call has been tentatively scheduled for Thursday, October 29, 2020.

I will now turn the call over to Kevin.

Kevin Johnson

President, Chief Executive Officer & Director, Starbucks Corp.

Well, good afternoon, and welcome. Thank you for joining us today. It's been three months since our last earnings call, as the entire world, all of humanity, has been navigating the COVID-19 pandemic through this very dynamic and challenging period. In times of adversity, values matter, and I'm very proud of how Starbucks partners around the world have responded during this global pandemic, united by our mission and values and guided by three simple principles: prioritizing the health and well-being of Starbucks partners and the customers we serve, supporting local government and health officials as they work to mitigate and contain the virus, and showing up in a responsible and positive way in each and every community we serve. The dedication, agility and positive energy of our partners inspires me. And for that, I am grateful.

Throughout this dynamic period, I believe the combination of principled decision-making and transparency in our communication has built trust, trust with all stakeholders. We provided Starbucks partners economic certainty through the shutdown while prioritizing their health. As we reopened stores, we created safe, familiar, and convenient experiences for our customers. We remain committed to doing so as we adapt the store portfolio to cater to evolving patterns of consumer behavior, including on-the-go consumption, mobile order and pick-up, drive-thru, and contactless pick-up and delivery in accordance with our multiyear strategy which has been further validated by the unfortunate dynamics created by COVID-19.

We showed up in the community to provide free coffee to the frontline healthcare workers who have been caring for those in need. We collaborated with our suppliers, and every step of the way, we supported our global license partners in markets around the world.

With a strong balance sheet, we took appropriate steps to ensure liquidity and maintained our quarterly dividend payment to shareholders while maintaining flexibility for the future, and we did all of this while continuing to advance our long-term strategy to position Starbucks for continued success.

Trust is earned, and building trust with all stakeholders is a very important attribute of Starbucks. I believe the significant investments we made this quarter have inspired Starbucks partners, strengthened customer loyalty, and will pay dividends long into the future as the Starbucks brand is stronger than ever.

On today's call, I will summarize the business recovery results that we are driving as we navigate the current situation and how we are rapidly adapting our business for this new reality. My hope is that from this call you understand and take away two important points.

First, our recovery plan is working. With the vast majority of stores around the world now reopened, we saw meaningful improvements in both sales and profitability as the quarter unfolded. Additionally, customer affinity for Starbucks is very strong as demonstrated by improvements in our customer connection scores, growth in customer loyalty, and market share gains.

While we anticipate these improvements to continue, our balance sheet and the strategic actions we have taken to position Starbucks to weather a more protracted disruption in global economic activity.

And second, in response to clear shifts in consumer behavior and preferences, we are now accelerating strategic initiatives for the future and positioning Starbucks for continued long-term growth.

We have moved aggressively to advance our evolution of the store base to accommodate trends that we have long seen emerging in our business that were only exacerbated by COVID-19. When taken together, these two points indicate a bright future ahead for all stakeholders of the Starbucks Coffee Company.

Let me begin in the US, where the recovery accelerated throughout Q3. We exited the quarter with 96% of stores open, up from 44% at the beginning of the quarter. With health and wellbeing top-of-mind, we monitored trends and quickly adapted to support our partners and serve our customers safely and responsibly.

Through a combination of new store operating protocols and service channels, we were able to amplify a number of contactless experiences for our customers, including drive-thru, entryway pick-up with Mobile Order & Pay, and delivery. And with new proprietary data-driven decision tools that monitor public health conditions, government guidelines, customer preferences, and partner sentiment in real-time, we were able to gradually and safely reopen a select number of our US stores for limited seating experiences, expanding to nearly 30% of our US company-operated stores by the end of the quarter. As a result, weekly US comps steadily improved throughout the quarter from the low point, a decline of minus 65% in mid-April, up to minus 16% as we exited Q3. And through all of this, we posted all-time high customer connection scores.

Looking specifically at the comps of the 3,100 US stores that remained open throughout the entire quarter, those stores improved sequentially from minus 14% comp in May to minus 1% in June to a positive 2% comp for July month-to-date. We have now developed new levels of agility and resilience that position us well for the future with the mindset and capability to safely, effectively, and confidently drive our continued recovery.

We recognize that markets will experience varying levels of COVID-19 impact until new therapeutics and vaccines are developed, and we are well-positioned to navigate this phase of the pandemic.

Today, customers are seeking safe, familiar, and convenient experiences in many aspects of their lives, and in that regard, our digital assets have proven to be a competitive advantage. Within the quarter, we saw significant acceleration in the number of customers who downloaded the Starbucks app and joined Starbucks Rewards, totaling 3 million in the quarter and up 17% from Q2.

Additionally, engagement with Starbucks Rewards customers outpaced non-Starbucks Rewards members, with year-over-year sales growth from Starbucks Rewards customers turning positive in early July. As a result, Starbucks Rewards as a percentage of tender in Q3 rose 4 percentage points from a year ago to 46% which is above the pre-COVID trend, highlighting our success in acquiring new loyalty members as well as reengaging our existing customer base.

And finally, customer usage of mobile ordering increased to 22% of total transactions, up 6 percentage points from a year ago.

Although our digital platform continues to be a source of strength, disruption to the weekday morning routines, notably commuting to work and school, is a headwind we are focused on across the US as we continue to recover our business. We continue to see improvements in the morning peak period as well as some customer occasions shifting to later in the morning daypart. As we see customer visits shifting from urban cafes to suburban drive-thrus, customers are also purchasing multiple beverages and food items on a single order, essentially a group order.

These dynamics have contributed to a meaningful increase in average spend per order compared to pre-pandemic levels, leading to 25% average ticket comp growth for the quarter. As we reopened stores to include mobile orders, entryway pick-up, and in-store to-go orders, ticket growth moderated and transaction volume increased as the quarter unfolded. Almost 90% of sales volumes in Q3 flowed through the combination of drive-thru and Mobile Order & Pay. In addition, with national coverage in the US, Starbucks Delivers transactions tripled in Q3 from Q2 levels, with the highest volume in the late morning and midday.

All of this indicates that customers are adapting their routines, and we are well positioned to drive further recovery by simply increasing throughput and enhancing those safe, familiar, and convenient experiences customers desire.

As I will discuss in greater detail later, that is why we are accelerating innovative store formats like Starbucks Pick-up and new operating protocols such as curbside delivery as they align closely with the customer preferences that have evolved as a result of COVID-19.

Let me now move on to China, where at the end of Q3, 99% of stores had reopened with approximately 90% having regular operating hours and over 70% having full seating. Building on the positive recovery momentum from Q2, China demonstrated sequential improvements in monthly comparable sales across Q3, exceeding our expectations for the quarter.

In addition to comp sales recovery, we reignited new store development, crossing the 4,400 store milestone with the opening of almost 100 net new stores in the quarter.

Mobile order sales mix reached 23% of sales in Q3, with 12% coming from delivery and 11% from Mobile Order & Pay, well above the mid-teens levels we saw pre-COVID.

As digital adoption accelerates in China, we continue to innovate in ways that deepen customer relationships and extend the reach of the Starbucks experience across a variety of digital platforms and ecosystems. In May, we launched a new WeChat mini-program with new functionality for WeChat users including Starbucks Delivers. And in June, we enhanced the Starbucks Rewards program introducing a multi-tier redemption system similar to what we rolled out in the US last year.

Fueled by these new digital initiatives, we have seen strong sequential growth in active Rewards members. In fact, the Q3 90-day active members increased 25% over Q2 to 9.9 million, representing 9% growth over the prior year.

We are pleased with the progress we are making in China to recover sales. However, we are reminded by the recent resurgence of COVID-19 cases in Beijing and the corresponding actions taken to mitigate the spread that our new normal requires us to monitor the situation in every community, rapidly adapt, and innovate in ways that continue to bring more customers into our stores and increase the frequency of those visits.

With the differentiated capabilities and strategic advantages we enjoy in China, including our digital partnership with Alibaba and our access to emerging technologies through our co-investment relationship with Sequoia Capital, we are confident that we will substantially recover our sales in China by the end of this calendar year, demonstrating the strength and resilience of the Starbucks brand in our fastest-growing market.

Moving to channel development, this has been a quarter where demand for at-home coffee has soared and our channel development business has demonstrated tremendous resilience and gained market share as customers adjust to their at-home routines.

In the US, Starbucks' share of total packaged coffee grew significantly in Q3, 21% growth in dollar sales, outpacing the coffee category which grew 13% in the quarter. Our domestic ready-to-drink business grew by 11%, gaining two points of share in Q3. Our Global Coffee Alliance with Nestlé combined with our ready-to-drink partners including PepsiCo and Tingyi, have extended our ability to meet customers where they are, which is particularly important in the current environment. We are now in 53 markets with the Global Coffee Alliance, more than tripling our at-home coffee presence versus a year ago, and we expect to be in over 60 markets by the end of this fiscal year.

With our near-term business recovery fully in motion and delivering results, let me now focus on how we are leveraging this disruptive period to accelerate value-creating initiatives that further differentiate Starbucks and fuel predictable, sustainable, long-term growth.

Why is this important? In every industry, there are periods of disruption that create great opportunity for those businesses that adapt to the disruption, invest in relevant ways, and strengthen their differentiation and competitive advantage. Those businesses that fail to evolve typically fall behind. Given the strength of our brand, our advanced digital capabilities, and our strong balance sheet, I believe this is one of those rare opportunities to move aggressively and further differentiate Starbucks from our competition. And I will highlight three areas where we are doing just that: convenient store formats, digital customer engagement, and plant-based menu items.

Over the years, we have demonstrated a clear track record of reimagining store formats to better serve customers, and we are now reimagining how we further elevate the customer experience by leveraging these various store formats to create a network of stores in a community. Think of this as blending highly complementary store formats throughout a community that collectively better serve the expanding and shifting need states of customers in that community, and thus increasing revenue in the trade area, while optimizing profitability and investment returns.

We have been blending store formats in suburban markets for years, where we have complemented traditional Starbucks stores, the third-place experience, with drive-thru and mobile order pick-up experiences that serve customers' needs for convenience.

We are introducing a simple handheld device to further increase throughput and improve the customer experience, and we are introducing a new curbside pick-up experience that will be available in 700 to 1,000 locations by the end of this quarter which enables incremental customer visits.

In urban core markets where drive-thrus and curbside aren't feasible, we will begin to reposition our store formats to create a blend of traditional Starbucks stores with new Starbucks pick-up stores. These stores are built in a smaller footprint and create a familiar and convenient walk-through experience that is very relevant to customers in urban markets.

Each of these Starbucks pick-up stores will ideally be located within a three- to five-minute walk from a traditional Starbucks store, giving customers the flexibility to enjoy their beverage in our store or on the go. We plan to accelerate the development of over 50 of these stores over the next 12 to 18 months with a view to have several hundred in the US over the next three to five years.

We have also accelerated the rollout of a similar concept in China, Starbucks Now stores, adding 9 new locations in Q3 for a total of 15. We are seeing firsthand the power of integrating physical and digital customer touchpoints to meet customers' growing need for convenience.

In addition to accelerating our store transformation strategy, we are creating new capabilities that expand digital customer engagement. We are having great success bringing new customers onto the app and into the Rewards program. We will build on this momentum in the fall when we introduce a new pay-as-you-go option for Starbucks Rewards members in the US and Canada. This significant new addition will open up an invitation to join Starbucks Rewards to a much wider audience. While nearly half of our sales now comes from Rewards members who are pre-loading their store value cards, we have heard from many more customers that they would like an option to earn rewards when paying directly with cash, credit, debit, and select digital wallets. By adding this capability to Starbucks Rewards, we will give customers more ways to pay and earn rewards when using the Starbucks app.

In China, since we began our China digital partnership with Alibaba two years ago, we've worked together to deliver innovate digital services to our customers and transform the coffee industry in China. As part of our ongoing partnership, we are expanding our reach to customers across the Chinese mainland by introducing the Starbucks Now Mobile Order & Pay feature to multiple platforms in the Alibaba digital economy including Taobao, digital mapping and information provider, Amap, local services app Koubei, and Alipay, which serve a combined user base of nearly 1 billion customers.

Through these apps, customers will be able to pre-order and pay for their favorite Starbucks beverage and food online and then pick up in person at most Starbucks stores across the Chinese mainland. Previously, this service was only available through our Starbucks China mobile app. This is a significant step forward and we value our partnership with Alibaba greatly.

We are listening to our customers and continually seeking ways to make Starbucks more relevant, inviting, and uplifting through personalized human connection. The seamless link between the customer experience we create in our stores and the power of the digital customer relationships.

Finally, our recent announcements of plant-based beverage and food innovation through partnerships with Beyond Meat, Impossible and Oatly reflect the fact that customers want more plant-based options. We believe that customers are embracing plant-based choices because they are GOOD GOOD, good for your health and good for the planet.

We are shifting more beverage and food menu items to include plant-based options. Recent examples include Cold Brew with Cinnamon Almondmilk Foam in the US and Oat Milk versions of two signature Starbucks beverages in China, Oat Milk Latte and Oat Milk Matcha Latte. Early results from these innovations are very encouraging, so we are accelerating efforts to expand these offerings for our customers and in the process, making meaningful progress against our planet-positive goals.

Let me close by reinforcing two key messages I hope you take away from this call. First, our recovery strategy is working as evidenced by the improving business results across all of our key segments. Second, we have future-proofed our business model and reinforced our balance sheet to enable us to play offense by accelerating key strategic initiatives that further differentiates Starbucks and reinforce the long-term sustainable growth opportunity ahead. Those two points reinforce an optimistic view of our future.

Before we conclude this call, I want to thank you all for joining us today. The last several months have been quite unprecedented in regard to public health and commerce given the impacts of COVID-19. Simultaneously, there is a powerful awakening underway in America to address systemic racism and social inequality, issues that Starbucks has always embraced, believing that we have a role and responsibility to advance positive change. That has never been more true than it is today. The mission and values that unites Starbucks partners continue to help us navigate these complex times and inspire us to promote equity, create opportunities, and build resilient communities.

And building upon the deliberate actions we have taken to provide a warm, welcoming, and safe environment for everyone, our work will not end. This is who we are at our core, and it is what our partners and customers expect of us.

I again thank all Starbucks partners. Your commitment, dedication, and caring for one another as well as our customers in the communities in which we operate through this pandemic is heartwarming. You are the heartbeat of Starbucks, and I am proud to work in service of you.

As always, we look forward to bringing you along our journey to create opportunities and strengthen our communities. Thank you for your time and attention today and for your ongoing support.

Now, over to Pat.

Patrick J. Grismer

Executive Vice President & Chief Financial Officer, Starbucks Corp.

Thank you, Kevin, and good afternoon, everyone. I will start by echoing Kevin's appreciation for all Starbucks partners, who have worked tirelessly to deliver safe, convenient, and familiar experiences for our customers and to support our communities under very challenging circumstances. They are the heartbeat of our company and our inspiration.

Although the impacts of COVID-19 weighed heavily on our Q3 financial results, we are encouraged by the fact that our sales and profits across all our operating segments recovered more quickly than we expected and that our very strong balance sheet has allowed us to make significant and important investments in the business for the long-term while weathering the pandemic.

For the quarter, Starbucks reported global revenue of $4.2 billion, down 38% from the prior year. We estimate the COVID-19 impact on consolidated revenue to be approximately $3.1 billion primarily due to temporary store closures, restricted sales channels, shortened operating hours, and reduced customer traffic.

Non-GAAP EPS in Q3 was a loss of $0.46, down from a profit of $0.78 in the prior year inclusive of an estimated $1.20 negative impact of COVID-19 which includes flow-through on the revenue impact that I noted earlier as well as significant investments that we made in response to the pandemic which I will outline later. Non-GAAP EPS was considerably better than the preliminary guidance range that we provided in our 8-K on June 10 driven by better-than-expected sales and margins.

I will first provide some highlights of segment operating results and consolidated margin performance for Q3. I will then discuss our guidance for Q4 and fiscal 2020, followed by a preliminary perspective on fiscal 2021.

At $2.8 billion, revenue for our Americas segment was 40% lower in Q3 than the prior year largely due to a 41% decline in comparable store sales including minus 40% in the US. We estimate the decline in Americas revenue and operating income attributable to COVID-19 in Q3 to be approximately $2.3 billion and $1.5 billion, respectively. This equates to a flow-through rate on lost sales of approximately 65% for Q3 which was a significant improvement from Q2 but still materially higher than the 50% variable flow-through rate that we typically observe in our business primarily due to incremental partner support costs, net of certain government stimulus program benefits as well as incremental store operating expenses.

Importantly, both sales and profitability trended positively across the quarter with sequential improvements in each month, and comparable store sales were toward the better end of our guidance range. The US business posted a comparable sales decline of 19% in June, improving from minus 43% in May, restoring the business to positive profitability for the month.

Moving on to International, this segment's comparable store sales declined by 37% in Q3 relative to the prior year but exceeded the expectations we shared last month primarily driven by Japan's faster-than-expected pace of sales recovery boosted by successful seasonal product promotions. The segment's comparable store sales in Q3 also reflect a 2% benefit related to temporary value-added tax, or VAT, exemption in China. This benefit was largely offset by traffic softness that emerged in Beijing in the last two weeks of the quarter due to a resurgence of COVID-19 in that city.

For the month of June, China's comparable store sales declined 16% after excluding an 8 percentage point VAT exemption benefit, about half of which was related to a true-up for the first two months of the quarter. This was a notable sequential improvement to May's comp on a like-for-like basis. For the third quarter, China's comparable store sales declined 19% including VAT favorability of 4 percentage points.

International's revenue of $950 million in Q3 was a 40% reduction versus the prior year primarily due to the 37% decline in comparable store sales. Also contributing to the decline were lower product sales to our licensees as a result of lost sales related to the COVID-19 outbreak as well as temporary royalty relief that we granted our international licensees. And there was an additional 2% revenue dilutive impact of transitioning our Thailand business to licensed operations last year.

These adverse year-over-year revenue impacts were partially offset by net new store growth of 9% over the past 12 months. We estimate that the COVID-19 impact to the decline in International's Q3 revenue and operating income was approximately $760 million and $420 million, respectively.

The improvement in International's flow-through rate on lost sales of roughly 55% in Q3 from 60% in Q2 was attributable to favorable items unique to the period, primarily temporary government relief programs, the temporary extension of China loyalty program benefits during the pandemic, and limited time rent concessions in both China and Japan.

On to Channel Development. Revenue was $447 million in Q3, a decline of 16% from the prior year. When normalizing for the 21% unfavorable impact of lapping Global Coffee Alliance transition-related items that benefited the prior year including higher inventory sales as Nestlé prepared to fulfill customer orders, Channel Development's revenue grew 5% in Q3 over the prior year. The growth was driven by strong packaged coffee and single-serve product sales, offsetting the adverse impact of COVID-19 on the segment's food service business. Channel Development's non-GAAP operating margin was 35.6%, an improvement of 120 basis points over the prior year.

Normalizing for the 460 basis point impact of the transition activities I just mentioned, Channel Development's non-GAAP operating margin contracted 340 basis points in Q3. The contraction was due primarily to a business mix shift within Channel Development as well as deleverage on fixed coffee manufacturing costs shared across the company's operating segments driven by lower retail production volumes resulting from COVID-19.

At the consolidated level, non-GAAP operating margin was minus 12.6% in Q3, down from 18.3% in the prior year. As you would expect, much of the year-over-year reduction in our operating margin was due to sales deleverage as well as incremental expenses to provide a safe experience in our stores all related to the impacts of COVID-19. We estimate this to be approximately 80% of the margin decline. The remaining 20% primarily reflects substantial and very intentional investments that we are making in the brand and to build trust with key stakeholders, recognizing that these relationships are an essential part of our brand and critical to our ability to not only recover from the effects of the pandemic but also to strengthen our competitive position for long-term growth.

These investments totaled approximately $350 million in the quarter and were focused on three key areas. First, we invested in our partners as they are critical to the Starbucks experience and instrumental to our long-term success. For most of the quarter, including during the period of extensive store closures, we provided our partners with salary, wage, and benefits continuation as well as temporary premium pay in the US and Canada for those who worked on the front lines of our business and enhanced assistance related to personal care and well-being net of subsidies from certain government stimulus program benefits. This represented about 85% of our total investments for the quarter.

Second, we supported our international licensees who are our partners in driving long-term growth globally by temporarily extending more flexible development terms and royalty relief.

And third, we helped several strategic suppliers weather this crisis with certain accelerated payments in effect through July and by honoring minimum supplier commitments during periods of depressed sales volumes so they can sustain the supply of our proprietary products and services in support of our ongoing product innovation. We are fortunate that the scale of our business and the strength of our balance sheet enabled us to invest as we did consistent with our mission and values as a company while positioning us well for the future.

Our $3 billion bond issuance in May enabled to us to fund these investments, cover our capital expenditures, pre-fund next year's bond maturities at attractive rates, and of course, sustain our quarterly dividend payments, honoring our commitment to shareholders. Importantly, as we exited Q3, we were cash flow positive with upward momentum, setting us on a solid path to reduce our financial leverage in future quarters.

Moving on to our outlook for Q4 and fiscal 2020, starting with a metric that in our view defines recovery for our retail business, comparable store sales growth.

Globally, we expect comparable store sales for Q4 and for fiscal 2020 to decline between 12% and 17%, demonstrating sustained sequential improvement including across both of our key markets of the US and China. We also expect Americas and US comparable store sales to be down 12% to 17% for Q4 and for fiscal 2020.

While the recent flare-ups of COVID-19 in several parts of the US underscore the persistent uncertainty in our operating environment, we expect continued improvement in our US business in Q4 bolstered by the focused actions that Kevin described in relation to our contactless customer experience, digital capabilities, and beverage innovation.

Currently, with modified operations and limited cafe seating in nearly 40% of our stores as well as 4% of the portfolio remaining closed, we estimate that our fiscal July comparable store sales for US company operated locations will be approximately minus 14%, a sequential improvement from the minus 19% that we delivered in June even as we dialed back some of our US operations in response to some regional COVID-19 flare-ups.

Moving on to our International segment, with the expectation of COVID-19 impacts continuing to ease in the fourth quarter, particularly in Japan, we now expect International's comparable store sales to decline between 10% and 15% in Q4, including a 3% favorable VAT impact. For China specifically, we expect Q4 comparable store sales to range between flat and minus 5%.

Although this is generally in line with our previous guidance and now reflects both a new tailwind and a new headwind, the new tailwind is the temporary VAT exemption which I mentioned earlier, benefiting China's fourth quarter comp sales growth by about 4 percentage points. The new headwind is a combination of factors. First, COVID-related emergency response measures in Beijing where Starbucks currently has over 360 locations. And second, a prolonged slowdown in international and domestic travel, impacting Starbucks locations at China's airports and tourist venues.

For the full fiscal year, we expect China's comparable store sales to decline in a range of 15% to 20%, including a 2% favorable VAT impact. And for International, we expect full year comparable store sales to decline in the range of 20% to 25% in fiscal 2020, including a 1% favorable VAT impact.

As an indication of the continued recovery that we're seeing in this business, we estimate that China's comparable store sales growth will decline approximately 12% to 14% for the month of July when excluding a 4 percentage point benefit from the temporary VAT exemption. This is sequentially better than June's result when China's comparable store sales growth declined 16% when excluding VAT favorability of 8 percentage points. We expect the VAT exemption will expire at the end of December.

Finally, Channel Development. This segment's revenue is expected to decline between 5% and 6% on a reported basis for the full year 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.

Adding it all up at the enterprise level, globally we expect revenue to decline between 10% to 15% in Q4 versus the prior year, primarily reflecting the negative impact of COVID-19 which we estimate to range between approximately $1.4 billion to $1.65 billion.

We estimate the operating income decline related to COVID-19 to be approximately $850 million to $1.1 billion globally, reflecting a flow-through rate of roughly 60% to 65% on lost sales in Q4. This is roughly comparable to the flow-through rate that we delivered in Q3 as we expect improved sales leverage in Q4 will be offset by the absence of nonrecurring margin benefits that we realized in Q3.

With continued sales and margin recovery, we currently expect the business will return to profitability in Q4, with EPS improving very meaningfully compared to Q3. We now expect GAAP EPS in Q4 of $0.06 to $0.21 and non-GAAP EPS of $0.18 to $0.33.

This current outlook for Q4 coupled with our better than expected results in Q3 yields a raise to our full year expectations for EPS in fiscal 2020 compared to our prior forecast. We now expect GAAP EPS in fiscal 2020 of $0.50 to $0.65 and non-GAAP EPS of $0.83 to $0.98.

Now I'd like to share some perspective on our US and China recovery curves going forward. Based on what we've learned as we've navigated the impact of COVID-19 for the past six months as well as the innovations and growth that we've planned for next year and barring any new major and sustained waves of infection and/or global economic disruptions, we anticipate that comparable store sales will substantially recover in China and the US in fiscal 2021 by the end of our first and second quarters, respectively. Additionally, we expect that margin recovery for each business will trail sales recovery by about two quarters.

As we believe we are now past the depth of the pandemic and are on a steady path to full recovery and as we've successfully bridged our liquidity needs, we will now return to our normal cadence of investor updates and look forward to sharing our continued progress with our fourth quarter earnings report in October.

In summary, Starbucks sales and profits are recovering nicely. Our liquidity position remains strong and continues to improve, and we are continuing to invest in growth and the future of our business. It has been a very challenging quarter for Starbucks as it has for many other businesses, but we believe the worst is behind us. We have developed a new level of agility and resilience for the future. The considerable investments we have made in our partners and other stakeholders which honor our company mission and values combined with evolving our store portfolio leave us as confident as ever in the unique strength and appeal of our brand and position us to unlock the full potential of Starbucks.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Your first 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. Just looking to talk a little bit about the broader outlook from a consumer perspective. It seems like on the heels of COVID, most consumers and investors alike seem like we're entering a recession. So a couple of questions related to that.

I'm just wondering if you could talk about your performance a dozen or so years ago and why maybe the brand is better insulated this go-around. Maybe comparing and contrasting the US versus China.

And then just to clarify, I think you mentioned that the China comps you expect to substantially recover by the end of fiscal 1Q. Perhaps a little bit of a delay from what I think you previously were saying by the end of the fiscal fourth quarter. I'm wondering whether you are seeing any signs of a China consumer slowdown at all in recent weeks. Thank you very much.

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

A

Yeah, Jeffrey, this is Kevin. I'll take your questions. First of all, I'll start with your second question, China. I think, as we see a resurgence of cases similar to what we've seen in Beijing, that causes a little bit of a – that's what's caused a little bit of the delay by a quarter in China. Not significantly. It was about I'd say four or five weeks, and now Beijing is back on a positive trajectory. But because it was such a large market, I think that's what slowed it down. But it has nothing to do in my opinion with anything related to the economic. It was more – it's more just as the resurgence happens in a large market like that that we – when it happens like that, we're able to sort of turn the dial back slightly on the range of customers' experiences we serve true to the principles that we outlined and we help support government and local health officials as they contain the spread of the virus. They successfully have done that in Beijing, and so then we start turning the dial back up and opening up those customer experiences.

And I think that's a very positive thing because I think as a company we've now taken this playbook that was developed in China and adapted for the US and we basically have embedded it into our store protocols and our operating procedures so that in 32 stores (sic) [32,000 stores] around the world if there happens to be a flare-up in a certain city or a certain portion of a market, the stores in that market have the agility to basically turn the dial down if they need to or turn it back up if things are recovering, and that puts us in a position of confidence in how we can continue to navigate the global pandemic as it evolves. And so that was the contributing factor in China.

In terms of recession, I'll leave the predictions of economic growth to the economists, but what we've seen is continued demand for Starbucks. In fact, you look at what we've outlined, the number one thing we can do to continue to grow our same-store comps on the recovery is basically increase the throughput in the channels that are safe, familiar, and convenient. And that's why, for example, we're deploying these handheld point of sales. I don't know how many of you have seen a drive-thru, Starbucks drive-thru. There's typically cars lined up and oftentimes out into the street. So where we deploy this handheld point of sale, we can now have a Starbucks partner out there taking orders walking through that line of cars, which is going to dramatically increase the throughput at drive-thru. Similar, enabling curbside will open up more customer occasions for us to continue to drive more transactions into our stores.

And so I think based on what we're seeing in terms of the demand and by being able to increase throughput in those channels that are viewed as safe and convenient by our customers, that's going to help us on the recovery curve.

In terms of should recessionary periods start to hit, I think we've differentiated ourselves. We've got lots of points of presence. We're serving customers. I think the brand is strong. Our digital reach is strong, and I think we're well-positioned to navigate anything that might come our way.

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

A

Jeffrey, this is Pat. One thing I would say to build on what Kevin has said is that if you compare Starbucks today to where we were during the last economic recession, today we have an industry-leading digital platform and a Rewards program that didn't exist back in 2008, 2009, and that's an important part of our competitive advantage and gives us more resilience today compared to 10 years ago.

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

Oh, hi. Thank you. I just wanted to ask a bit about the guidance, if I could. You said that sales and operating profits recovered more quickly than expected, but to me it looks like the big difference is more on the profit line with the comps this quarter kind of pretty consistent maybe with guidance. I was just curious basically what the – where – why there was sort of better-than-expected flow-through considering how much of it was a function of discretionary investments.

And then if I look at 4Q, just trying to understand again the comps actually maybe the midpoints of the same or a bit lower in most markets, but are you being conservative again on the EPS? Just trying to understand. There's a lot of moving parts, but if I sort of reconcile the top line versus the EPS, it seems like there's been a little bit of a disconnect this quarter and I'm trying to figure out if that'll happen again in 4Q or even next year since you've said that profit recovery might lag top line. Thanks.

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

Thanks, Sara. Pat, do you want to take that one?

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

Yes. Thank you, Sara. So in relation to Q3, compared to the expectations we had when we filed our 8-K on June 10, you're absolutely right. We saw much better flow-through, more profit performance than we did improvement in sales. We did see stronger-than-expected sales recovery across the month, but the profit improvement was outsized in relation to the sales recovery, as you've highlighted. And that's primarily due to the fact that as we have increasingly better visibility to the shape of our sales recovery curve, our operators are in a much stronger position to manage with much greater efficiency labor deployment and inventory, and so as a consequence, we saw much better profitability than we had anticipated.

I would also highlight in particular the performance of our Japan business because they have a rather strong improvement in sales and because they're a company on market we saw that – saw with that a significant improvement in profit for the month of June compared to our original expectations.

In relation to Q4, I think it's fair to say that our outlook is pretty comparable to what we had forecasted as of that June 10 8-K. We have narrowed the range for the US business and for the Americas generally because we have more visibility to our results for the quarters. We're nearly one month into our fourth quarter. At the same time, we have much better visibility to our ability to manage the middle of the P&L, and so we feel very comfortable with the ranges that we've given for EPS as well.

In relation to next year you asked about fiscal 2021 and I provided in my prepared remarks a very preliminary perspective on the shape of our sales recovery curve, noting that our margin recovery would likely lag sales recovery by a couple of quarters. The fact is that it's very early to predict what next year is going to look like, but based on the experience we've gained to date, based on how well we know our brand and how consumers are responding to our brand, based on the strength of our Rewards program and our digital platform, we are building operating plans for next year that presume the levels of sales and profit recovery that I mentioned. So it is on that basis that we've provided that preliminary perspective and will continue to keep investors updated as we go looking forward to providing more refined perspective with our Q4 earnings call, by which time we will have developed our operating plans for fiscal 2021. Thank you.

Operator: Your next 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, and congrats on navigating through what we hope is the worst of the COVID shock here. But I have a question really on the US business, and I think, Kevin, you mentioned the morning routine business is going to be the most difficult to build back. And I was wondering if you could elaborate on what the plan is to build that back specifically, and perhaps what you've seen in the markets where the economies maybe opened up earlier if you're starting to see that business come back, for example, in the Southeast or other markets that might have opened earlier than some of the core markets.

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

A

Yeah, David, thanks for your question – or your comments and for your question. Why don't I let Roz describe sort of the initiatives we have focused on that morning daypart, and then I'll sort of punctate a couple things. So, Roz, let me hand it over to you.

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

A

Thanks, Kevin. Thanks, David, for the question. First of all, morning daypart as you well described is important to us. We have seen a shift in the customer in terms of how they view their morning, and we're seeing a shift to midmorning around the 9:30 AM timeframe and then another pick-up in the afternoon around 2:00 PM. And because we've created, so many tools, decision-driven tool that we've designed specifically for labor planning, we've shifted our labor to those timeframes understanding what is shifted in the customers' patterns and their routines.

In addition, we're also seeing that in some of our really dense workplaces, for instance, downtown areas where we have stores where there's more work from home in those geographies, those have been slower to recover. And so we're watching those carefully. But those are also the areas – those dense areas that we are bringing in our new trade area transformation work. We're realigning the network of stores to increase what we are seeing in terms of revenue in that trade area and optimizing the profitability. So those dense areas are being transformed by the new network of stores.

Additionally, I'll tell you that we are doing the work to reach a broader level of customer base with a new design in our loyalty program, and so you may have heard the announcement around our new pay-as-you-go plan. That will allow us to expand payment options and ways to earn stars, and this we believe will provide meaningful impact on our business results overall, also helping us understand the activity of the customer as we reward the loyalty and delivering personalized offers to the expanded customer base.

So starting this fall in the US and Canada, you'll be able to download the Starbucks app and sign up for Starbucks Rewards. You'll be able to pay with a credit or debit card, cash, or select a mobile wallet to earn the stars without having to pre-load the Starbucks card within the app. And so customers can link those card payments to a PayPal account and we believe these are the kinds of initiatives that will make a difference as we try to regain the most important parts of our business and watch what happens as the transition from work from home returns back to work from office, and we'll be watching the customer patterns very carefully and adjusting.

We're really comfortable that we now have so many different channels to our business adding drive-thrus out in those metro suburban areas near where people are working from home. It's our highest concentration of drive-thru units, and so we feel like this new agility and resilience that we've built into the business will allow us to look at that morning daypart, adjust to the transitions we're seeing in midmorning, early afternoon, and then bring in a new customer base, additional customer base with the new Rewards program.

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

A

Thank you, Roz. I think you hit the right thing. The digital customer relationships. Just keep in mind, we just added three million new digital customers that registered for the Rewards program and being able to communicate with them personally. And then as Roz said, the work they've done on increasing throughput at drive-thru and launching curbside that just opens up new channels. So that's spot-on. Thank you, Roz.

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

At this time, there is no response from Ms. Zackfia's line. It appears your question has been withdrawn. And I will proceed to the next question. The next question comes from the line of John Glass with Morgan Stanley. Please proceed with your question.

John Glass
Analyst, Morgan Stanley & Co. LLC

Q

Thanks, and good afternoon. I wanted to go back to the comment, Pat, you made about the margins recovering slower than sales. Just at a high level, a lot of retailers, a lot of restaurants have determined they can do more with less during this period of time and they've learned that they can make labor more efficient, menus more efficient. Why wouldn't that be the same case for Starbucks? It should be the opposite. And I would also think that digital transactions are more profitable, so that would sort of accelerate that. Or is there some embedded assumption about reinvestments so that some of these new channels actually aren't as margin accretive as maybe I'm assuming.

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

A

Yes, John. Happy to answer your question. We do expect margins will improve gradually as we move through the fourth quarter and into next year. But in the next couple of quarters we do expect margins will continue to lag prior year. And although the margin impacts of partner benefits and inventory reserves are expected to subside considerably in Q4, the leading driver of margin pressure will be continued deleverage of fixed costs such as occupancy and depreciation expense as we work to restore sales. So it's largely a function of the speed with which we can recover sales and then how we manage some incremental costs to our business because we do expect to see certain costs persist due to our new way of operating that includes cleaning supplies and the associated labor, but it is premature to say when those costs will drive a structural change to our operating margin as we continue to innovate our operating systems and technology to improve throughput and drive efficiencies.

We also expect a margin tailwind from the transformation of our US urban market strategy that has rolled out and includes the repositioning of some existing assets and that will help to offset any new incremental costs. And we also expect margin benefits from ongoing efforts to renegotiate operating leases. So we do expect to see a combination of margin headwinds and tailwinds, but far away the biggest driver of the margin recovery will be the sales recovery. However, we do expect that there will be that lag between sales recovery and margin recovery as we continue to refine our ability to operate differently in the new environment.

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. I hope you guys can hear me now.

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

A

Hi, Sharon. We can hear you.

Sharon Zackfia
Analyst, William Blair & Co. LLC

Q

Okay. Perfect. So I wanted to follow-up on Roz's comment about the pay-as-you-go feature for Starbucks Rewards. Is that just rolling out in the US, or are you also making any modifications overseas? And can you help us think about where that has the greatest impact? I mean, is it a customer-acquisition tool, does it really widen the funnel? Is it a frequency dynamic, and any kind of initial margin thoughts? I know that the Rewards is a little bit less frequent, I think than the regular Rewards program, but any clarity around that would be helpful.

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

A

Great. Go ahead, Roz.

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

A

Sure. So Sharon, first of all, the current Starbucks Rewards members they'll continue to enjoy all the benefits of the current program. The current loyalty program and usage of the app. And then those members can choose to keep paying with their pre-loaded Starbucks card to earn two stars per $1 and they now have the option to earn 1 star per $1 spent when you pay with a credit or debit card, cash, or select mobile wallet. So it serves two purposes. One to expand the funnel on the customer base, but we actually believe that we'll get even deeper penetration with our Starbucks Rewards members as well, so it will do both of those things. We're rolling this out in US and in Canada. So this program is just to North America at this time and there is a different program that we use in 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 so much. First, to follow up on the efficiency question, then a separate one on efficiency as well. It would kind of be apparent that you would be able to run stores with less operating hours if there is a shift towards digital, if there's a shift towards off-premise. If you could give comment on that specifically because that's what we are hearing from other restaurants.

And then secondly, as we think about the organization and the overall growth plan that the company has, what type of efficiency and effectiveness exercises have perhaps emerged beyond what you've previously said on a corporate or G&A perspective, a support perspective as we think about 2021 and 2022 of perhaps optimizing some of the organizational structure.

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

A

Thanks, John. Roz, why don't you take the part of John's question on what we're doing with operating hours and sort of efficiency in the store, and then, Pat, why don't you take the back half of his question on G&A and how that all comes together on the P&L. Roz?

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

A

Yes, so first of all, John, what we're doing to prepare for labor in the stores is critical for us. As you can imagine, labor being for any retailers our greatest expense, and so being very efficient in terms of how we manage those labor hours in addition to the productivity. And so we have productivity tools in the store that help us manage when labor hours are needed. We're watching things as simple as infectious rates and so when those rates rise in certain areas, we will adjust the hours in those stores. We'll know that we have partners available to work and we will apply them to the store, and so we do have methods in place to make sure that we're managing just as efficiently as possible in these uncertain times. So we have that work ongoing.

We've also you likely heard earlier probably four to six weeks ago where we made an adjustment in our stores around partners who wanted to return to the stores and those who decided that they wanted to work elsewhere and find a new career. And so we've adjusted appropriately. However, we continue to run hours based on store and demand in that area, and we've created our own decision tools to decide what that looks like. So we continue to work that like we've done in the past with a lot more visibility over what's needed to fulfill the demand in those stores.

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

A

And then, John, just to pick up on some additional aspects of our margin outlook, it's important to bear in mind that as we do innovate new channels of distribution at our stores, for example, curbside delivery or as we anticipate the longer-term growth of third-party delivery, those channels require incremental costs but they're necessary in order to capture the incremental sales. So those would be a couple of examples where we see growth that may be margin-percentage dilutive but dollar profit accretive.

And so to Roz's point, the team continues to work through ways that we can improve operating efficiency in the store to help offset some of these incremental investments to accommodate an evolution in the overall shape of our business.

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

A

Pat, I'd also like to add that we are also working as we've talked about before to look at equipment efficiencies in our stores and so the Mastrena II is at 4,000 stores as we speak and so we continue to look at equipment and all operations behind the bar as well.

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

Andrew Charles
Analyst, Cowen and Company

Q

Great. Thank you. Roz, I'm trying to get a better sense of the size of the prize of curbside delivery. So just curious, how many stores are offering the curbside pickup now in the context of how many stores, that are non-urban stores without a drive-thru in the portfolio? And curious on how you see this progressing and really what limits the speed at which you can add this capability given this obviously is a lot easier from a process perspective relative to the real estate you're exploring on some of these smaller-format locations.

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

A

Roz, do you want to take that?

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

A

Sure. Andrew, thanks for the question. So we were in test at about 250 stores. Really pleased with what we saw in those stores with curbside which encouraged us to accelerate and we will be in close to 1,000 stores in short order here. So we continue to push curbside. The interesting thing about curbside for us is that it is tech-enabled, so you can access curbside from the app, where it is available currently. And so we're continuing to roll that out and so we expect to continue to see what we saw in that 250 store test trial that we've been running just prior to COVID. So this is an acceleration of a plan that we've already had and so we look forward to curbside to give our customers just one more contactless opportunity and our partners a chance to deliver the best customer service to our customers.

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

Matthew DiFrisco
Analyst, Guggenheim Securities LLC

Q

Thank you. Just had one follow-up on the dayparts. I guess from the text, it says, I mean, you're seeing growth and it seems to be shifting in the later part of the morning, but I guess with the down 14% in July, that's correct to assume that the afternoon daypart or post 10:00 AM daypart is meaningfully positive?

And then I wonder if you can comment a little bit about marketing. One of your bigger peers today talked about having sort of entering the second half of this year with the calendar year with a war chest for marketing dollars spent. What type of dollars should we think about on a year-over-year basis? Have you sort of deferred some to be spent and accrued it in the first half that could be actually deployed and put into the marketplace in the second half? Thank you.

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

A

Thank you, Matt. Roz, why don't you go ahead and take both of those questions, if you could.

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

A

Sure. So Matt, to your first question about daypart, one of the things that we're seeing also is a shift to later morning and another pick-up in the afternoon is we're seeing expanded tickets. So we are seeing group ordering what we believe, we're seeing larger beverage size and additional beverage and food attached. And so we talked about that increase being 25% of what we've seen in our ticket expansion. So we are seeing that.

To the rest of your question around marketing, we've continued marketing, in the very beginning we ceased marketing because we had so many stores that were in transition from cafe to drive-thru. We reignited marketing. You've seen it in our work with our Happy Hour, our Double-Star Days, and then the initiation of our summertime beverages, and then the discussion around our plant-based menu.

You'll see us coming into the fall with excitement around our work with Pumpkin Spice Latte. You'll see us market for our holiday beverage plans and then the work that we plan to do to market the new loyalty program, and the new loyalty program again is another way for us to have a new customer base attached to an app that we can speak to frequently and bring them into the store and increase frequency. So we have marketing planned for the remaining of the year and throughout fiscal year 2021.

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

A

And just to build on what Roz has said in relation to our fiscal 2020 spend, to Roz's point, the level of spend in Q3 was markedly higher as a percentage of revenue than Q2, in part due to some of the deferral of marketing activity. We do anticipate that our level of overall marketing spend in Q4 as a percentage of revenue will be pretty comparable to our full year rate. We are not anticipating that that overall level of spend will diminish going forward, but I would highlight that as a concept our advertising spend has historically been pretty low because of the strength of our brand and the amount of marketing that we attract.

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

Thank you. Pat, just unpacking your comments on the 2021 same-store sales recovery, do you anticipate store level volumes in the US fully recovering to pre-COVID levels by 2021? Or do you really need an environment to shift where employment is fully restored and people are back to their pre-COVID routines? Or can you get back there in this new-normal environment we're all living in?

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

A

Yes, Brian, thanks for your question. As I said in my prepared remarks, our preliminary perspective on fiscal 2021 presumes that there will be no major second wave or no major macroeconomic dislocation. It's nearly impossible to predict whether and when those might happen. Based on what we know today, based on how we see our business is recovering, we anticipate and we are developing an operating plan around the assumption that our US business fully recovers sales, meaning back to pre-COVID-19 levels by the end of the second fiscal quarter and that would be the end of March.

We're expecting China will fully recover about one quarter sooner. And then as I mentioned, we're anticipating margin recovery will lag sales recovery by about two quarters. That's a very preliminary perspective just to share with the investment community how we're thinking about the shape of next year, not being able to predict whether and when some other events might happen. We have to get on with our business. We have to prepare operating plans and focus our teams on continuing to deliver results.

We're pleased overall with the progress we've seen to-date. We still have a long ways to go to get back to full recovery, but we're optimistic based on the strength of our brand and the strategies and the initiatives that we have to drive sales and to improve margins.

Operator: Your next question comes from the line of Jon Tower with Wells Fargo. Please proceed with your question.

Jon Tower
Analyst, Wells Fargo Securities LLC

Q

Great. Thanks for taking the question. A lot of them have been answered already, but I am curious how you think about this potential longer-term shift in work from home for many consumers, and how you think about product innovation around that specifically. Do you see yourselves potentially offering some new items that you wouldn't be able to if consumers were not working from home as often? And also, even with curbside, do you see potential to add some new products that you might not be able to add without that option?

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

A

Yeah, Jon, let me comment, then Roz, I'll let you add anything. I think, look, we've always been really clear that the three things that we focus on that really drive our growth is, number one, the customer experience, that's the experience in our stores and these different channels we're talking about; number two is extending that experience in our store to digital customer relationships; and number three is primarily beverage innovation. We're a beverage-first company and then we attach food.

And so, I think that same formula works whether you work from home or you work from work. I do think what is the focus right now until there's a vaccine, we just realize that we've got to focus on those experiences that customers optimize around whether they're working from home or not which are safe, familiar, and convenient. And so our beverage innovation is going to continue to focus on all the great things we've been doing around our cold beverage lineup with cold foam, coffee-forward beverages, our refreshers, all of that is going to continue to move forward, and I don't necessarily see that as being a driver of the fact that people work from home or we have curbside. We're going to continue to innovate in ways that are relevant to our customers independent of the channel by which they buy from us.

I do think as Roz pointed out, we're seeing larger ticket, and I think part of that is a function of people work from home, they make a Starbucks run and they buy for the whole family, or they're buying more group sort of orders, they're attaching more food. And I think that bodes well for the innovation that we've been driving and announcing around our plant-based offerings.

Plant-based is becoming a very popular whether it's plant-based milks or the Impossible breakfast sandwich that we launched in the US, the Beyond Meat offerings that we've put on the menu in Canada and China. And so our innovation agenda is going to continue to drive around the things that we know are relevant to our customers, things that inspire our partners and stay true to handcrafted beverages. That's what differentiates us, and I think we're going to maintain a focus on those things.

Roz, if there's anything else you want to add or, and then Pat perhaps could comment, too. So let's go to Roz.

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

A

Yeah, just a few things. First of all, although our sales mix has really tilted to – more towards lunch and afternoon since the onset of COVID, morning still remains a significant daypart for us. So we're not walking away from that. There are some things that we're considering in terms of innovation and then there are some things that we're accelerating in the innovation pipeline. For instance, we're going to be introducing a plant-based protein box because we know in the afternoon there's this extra boost needed and so that will come forward quicker than planned.

We're also looking at things like, for instance, with curbside we're trying to bring the lobby to door side. So just recently we added merchandise to the app so then if you wanted to order for gift-giving, some of our serveware, a mug, a nice cup, so we've done some of those things, and we'll continue to do that because we're really listening to the customer and understanding what they need and we can evolve and then we can accelerate our innovation pipeline just as quickly as we can.

Pat, you wanted to add something?

Patrick J. Grismer

Executive Vice President & Chief Financial Officer, Starbucks Corp.

A

Yeah, thank you, Roz. I'd like to highlight specifically how our channel development business has benefited from work from home and how the team is looking at opportunities to capitalize on that. The volume we were seeing in at-home coffee remained at elevated levels across the quarter. Starbucks outperformed the category, we gained share and our core strategies for at-home coffee are generally the same, but we are looking at opportunities to sustain the momentum that we gained as consumers adjust to their at-home routines. For example, we're focusing on accelerating e-commerce based on the shift in shopping patterns and meeting consumers' evolving needs we're also looking at premiumizing the category, expanding consumption and driving loyalty through our channel development business as well. Thanks.

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

Chris O'Cull

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Thank you. Roz, would you help us understand the potential sales lift for a store that adds curbside, and maybe describe some of the other initiatives that you believe could have a meaningful impact on capacity and throughput.

And then, Pat, do you expect the benefit from the qualified payroll credits to be smaller in the fourth quarter than they were in the third?

Kevin Johnson

President, Chief Executive Officer & Director, Starbucks Corp.

A

Roz, why don't you take the first part, and then Pat will comment.

Rosalind Gates Brewer

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

A

Sure. Let me start off. First of all, Chris, your question around curbside and what would we expect in terms of upside there. It's encouraging what we saw in our trial base and we know that contactless experience for our customer is more present than ever, so we believe in this new channel for us. But it's really too early for us to tell what the real benefit will be, but we'll come back to you as this thing grows we'll let you know how that's working for us.

In terms of capacity and what we think could help, for instance our drive-thru lines this new handheld – that capacity that we are creating allows us to do what a lot of retailers call busting the line, actually, and so we're able to get out of the store get out in that line and put an order in a queue much faster and get those out-the-window times down, and get the beverage and the food items to the customer much quicker.

We're also doing work that handheld will enable if you wanted to just – if the line began to get long if you are picking up and trying to walk into the store. So between handheld and curbside, we feel like we're going to be able to deliver a different customer service and it'll unlock and enable some efficiencies that we need and speed. And so we're looking at those two as some key drivers.

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

A

And, Chris, in relation to your question regarding the government stimulus program benefits, the lion's share of our investment in Q3 was around catastrophe pay, a form of partner support and care. And that's where the government stimulus program benefits kicked in helping to offset a portion of that. So for Q4 since we have effectively sunsetted our catastrophe pay, we're not anticipating significant expense in Q4 and as a result, we would not anticipate significant government stimulus program benefits by way of payroll tax credits.

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

Dennis Geiger
Analyst, UBS Securities LLC

Q

Great. Thanks. Kevin, you talked some about how solid customer demand remains, and perhaps it sounds maybe a little change from pre-COVID levels and therefore I think you were highlighting the importance of throughput and operations to continuing to drive sales.

But anything more you can share with respect to existing customers using the brand a little bit less for now that their brand – that their routine has changed perhaps offset by new customers that you've gained or that have become heavier users over the last few months?

And ultimately is that a net benefit because the new customers become sticky, existing customers return to their routines, anything more there, metrics to share or just kind of how you're thinking about that customer dynamic? Thanks.

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

A

Yeah, thanks for the question. I'll start by saying throughout this quarter we have navigated the pandemic in a way that I consider very consistent with Starbucks' mission and values and in many ways we navigated this by prioritizing the safety and the health and well-being of our partners and the customers we serve. And unlike many, many others in the industry in April or, yeah, in April we closed all our stores with the exception of drive-thrus, and that was clearly to provide a safe environment for our partners and as well as a contactless experience for us to handcraft beverages and food items for our customers.

During that period, we had significant demand through the drive-thru. It was quite amazing the lines and the amount of time a customer would wait in line in drive-thru to get their Starbucks. And so that was the first indication that there's a very powerful customer affinity to Starbucks even in a global pandemic.

Now, as we started reopening stores in May and customers we began to with mobile ordering and contactless entryway pick-up, we continue to see customers coming back to us. Clearly, the priority or the customer behavior was around safe, familiar, convenient experiences, and so that's why I think we saw such a dramatic increase in the number of app downloads and customers that joined the Rewards program because that is the safest way to order. You order on your phone and then you can pick it up contactless or you can get it for delivery, and so that was another indication.

So we quickly figured out if we launch curbside, we're going to get more customers, if we put handheld point of sale at the drive-thru lines we get drive-thru. When we open our stores for to go orders or even limited seating, we see customers come back and yet at the same time we stayed true to the principles that we outlined which is prioritize the health and well-being of our Starbucks partners the customers we serve, to also support government and local health officials as they work to contain the spread of the virus. And third is to just show up in a positive and responsible way in every community we serve.

Now, when I look at the data, our customer-connection scores are at an all-time high, and part of that is I believe the way that we've navigated this has built trust. It's built trust in our Starbucks partners that we're always going to do the right thing. We put people ahead of profit. Whether it was providing economic certainty for our partners or ensuring that our customers had safe ways to interact with us. I think that deposit in the reservoir of trust is building and strengthening customer affinity.

Obviously, the deployment of Mobile reach is building more customers that become sticky. They build that relationship with Starbucks. We can communicate with them. We can serve their needs. We can personalize that experience for them, and then the investments we're making to make it easier for customers to have those experience is just – is continuing to unfold. And we saw that certainly in the month of June where we saw a very good response from customers that helped us exceed expectations on what we would see in sales and then that's continued to July to progress.

So when I look at the fact that our share in the month of June, we gained share in the month of June, and I'm confident that we're on a path to continue to gain share. So if there's any question that closing stores was going to create a longer term loss of market share is disproven because we saw clearly in the month of May we did – we were even on share, in the month of June we gained share and I suspect as we keep doing these things we're going to continue to gain share.

And in the process customer connection scores are at an all-time high and our customer affinity that we measure on a regular basis is also very strong. So I think we have line of sight visibility to what our customers need and want, and as we deliver that, they respond. And I think the plan that we have in place in accelerating the strategic initiatives are right in the sweet spot of customer – shifting customer behavior.

So I think about this as the investments we made this quarter, we're playing the long game. This is about building trust with our customers and then positioning Starbucks for long-term sustainable growth. And I feel very good about the fact that we're now in a position where we've operationalized these store protocols and we know how to adapt very rapidly and we do that with distributed leadership. 32,000 stores around the world. There's 32,000 store managers. Each one of them is paying attention to what's happening in their community. They have the playbook, they know how to adapt.

And so we're in many ways where back in March, April people would describe this as we're navigating a crisis, this global pandemic, well, today we're not – this is not a crisis any longer in my opinion. We are navigating a global pandemic, but we know exactly how to do it that's woven into the fabric of how we operate and partners are rising to the occasion.

So I feel very good about where we're at. I feel very good about the strategic initiatives and the data that we see on customer response is spot on. So that's where we are from where we were 90 days ago when we spoke with you last on the earnings call and it's all credit to our Starbucks partners. They've done a phenomenal job.

Operator: And that was our last question today. I will now turn the call over to Kevin Johnson.

Kevin Johnson

President, Chief Executive Officer & Director, Starbucks Corp.

Well, let me just thank all of you for joining us today. My hope is that through this discussion we've been able to give you a sense of the confidence we have in our ability to navigate this global pandemic. Our recovery strategy is working and we're accelerating the strategic initiatives that further differentiates Starbucks for the future.

We're doing this in a way that is true to our mission and our values, and we're on the front foot right now but also acknowledging that like everyone else in this world, we've got to monitor and adapt and be agile. But I'm very proud of my Starbucks partners and how they've responded and I just want to take an opportunity to thank all of you, our stakeholders, for your support and we look forward to the continued dialogue. So thanks everybody.

Operator: This concludes Starbucks Coffee Company's third quarter fiscal year 2020 conference call. You may now disconnect.