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Starbucks Corp. (SBUX)

Q3 2016 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon. My name is Stephanie, and I will be your conference operator today. At this time, I would like to welcome everyone to Starbucks Coffee Company's Third Quarter Fiscal Year 2016 Earnings 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] Thank you. Ms. Doraisamy, you may begin.

Durga Doraisamy
Director of Investor Relations

Thank you. Good afternoon, everyone. This is Durga Doraisamy, Director of Investor Relations at Starbucks Coffee Company. Thank you for joining us today to discuss our third quarter 2016 results, which will be led by Howard Schultz, Chairman and CEO; Kevin Johnson, President and COO; and Scott Maw, our CFO. Joining us for Q&A are Cliff Burrows, Group President, U.S. and Americas; John Culver, Group President, China, Asia-Pacific, Channel Development and Emerging Brands; Matt Ryan, Global Chief Strategy Officer; Adam Brotman, Global Chief Digital Officer; and Michael Conway, President of Global Channel Development.

This conference call will include forward-looking statements, which are subject to various risks and uncertainties that could cause our actual results to differ materially from these statements. Any such statements should be considered in conjunction with cautionary statements in our earnings release and risk factor discussions in our filings with the SEC, including our last Annual Report on Form 10-K. Starbucks assumes no obligation to update any of these forward-looking statements or information. Please refer to our website at investor.starbucks.com to find the reconciliation of 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 at investor.starbucks.com. Before I turn the call over to Howard, I would like to take this opportunity to make you aware of our Biennial Investor Day, which will be held on December 7 in New York City. More details will be coming soon. We hope to see you there, so please reserve December 7 on your schedule.

With that, I will turn the call over to Howard Schultz. Howard?

Howard S. Schultz
Chairman & Chief Executive Officer

Thank you, Durga. Good afternoon and welcome, everyone. In Starbucks' 24 years of public life, I can't recall a quarter quite like Q3 of 2016, when a confluence of social and political turmoil at home, weakening consumer confidence, increasing global uncertainty, and the launch of one of our most significant long-term initiatives of all-time all occurred within a single earnings period. In light of these circumstances, it would not be unreasonable to simply celebrate another quarter of record revenues and record EPS, our first non-holiday quarter with $1 billion of operating income, and operating performance well above our competitive set and at the very top of our sector.

But I want to address right out of the gate the two questions you're likely asking yourselves. Does a 4% positive same-store sales comp from our U.S. business in Q3 signify or even suggest a turning point in Starbucks' long-term growth trajectory? And does this comp figure in any way relate to the success and value of our Starbucks Rewards loyalty program? On today's call, we will demonstrate with clarity and specificity why our U.S. comps in

Q3 were an anomaly, and that we have clear line of sight to returning our business to historic levels of comp growth, which has been at or above 5% for the past 25 consecutive quarters. We will demonstrate how the Starbucks Rewards program has been strengthened in Q3 and how the improvements will fuel an even more powerful digital flywheel that will propel our business forward for years to come. And we will share details around a number of exciting new developments as we head into Q4 and prepare for fall and holiday that demonstrate why we are so confident going into fiscal 2017, and why we remain optimistic about the long-term growth prospects for each of our businesses around the world.

That said, with candor and humility, we acknowledge that in certain areas, we did not execute as well as we could have in the U.S. in Q3. Had we done so, we certainly would have reported stronger U.S. comps. So let me try and put you in our shoes and take you through what actually occurred. Very early in the quarter, and after months of planning, we began executing against what I am convinced will prove to be among our boldest and most strategic moves ever, the strategic shift of our tremendously successful loyalty program from a frequency-based to a spend-based model. The shift was a one-time event, a once-in-a-decade change built on carefully vetted analysis that showed that a spend-based program would best reward our most loyal customers and encourage all of our customers to visit us more often and spend more on each visit, and it would be more fair for all of our customers as well.

In addition, the shift would instantly eliminate a vexing in-store operating issue, order splitting, that was and has resulted in shorter lines, increased speed of service, and reduced line attrition. Now, given the sheer size, scale, and complexity of our Starbucks Rewards program and the mobile and digital technologies that support it, we knew there could be some hurdles to navigate at launch, particularly since the launch would coincide with the kickoff of our annual Frappuccino Happy Hour promotion, a nationwide event that typically ushers in the busiest time of year in our stores and consistently drives significant traffic and incremental revenue.

By way of example, 2015's Frappuccino promotion drove a 30% increase in revenue over the prior year. You may recall that on last quarter's call, we cautioned that the launch of the new Rewards program could result in some noise in our comp figures as customers and partners adapted to the program changes. What we underestimated was the interdependence of Starbucks Rewards and Happy Hour, and that two powerful initiatives competing for partner and customer mind share during a discrete period of time would disrupt what should have been strong, positive interdependence and leverage.

In hindsight, what we should have done was build customer awareness anticipation for the Frappuccino Happy Hour promotion as we have done so successfully in the past and given the promotion the breathing room it needed. At the same time, the Happy Hour promotion interfered with the results we were expecting from the Starbucks Rewards program launch.

By anyone else's standards, our Rewards results have been outstanding. We entered nearly 2 million new members year-over-year, representing 18% growth, and 300,000 net new members in Q3 alone, a time of year when we often see flat to negative membership growth. And we now have 12.3 million active Reward members in the U.S. and millions more worldwide.

We are already seeing the percentage of tender from Starbucks Rewards U.S. customers rise to 33% in Q3, up three full points from last year, continuing an established pattern in which revenue growth from Rewards customers typically outpaces revenue growth from non-Rewards customers. And we are seeing both incrementality of spend and increase in total profit per customer, both directly attributable to a customer's having joined the Rewards program. These powerful metrics bode extremely well for our business going forward, and having us continue to lean in and convert even more customers into the Rewards program.

In the months ahead, we will be launching even more initiatives to fully leverage Rewards as incentives for customer behavior and to encourage greater ticket and attach. What we did not and could not have fully anticipated was the profound weakening in consumer confidence in Q3 that has caused sharp declines in QSR and restaurant traffic overall and has many of our competitors struggling with negative transaction comps. And as I have mentioned in the past, Starbucks is not immune to macro challenges that impact our competitors and retail overall. But as with weather, we will not hold these challenges out as excuses. Instead, we will successfully manage and navigate through them as we always have.

So while we may have significantly outperformed the industry and our competitors in Q3, we did not fully overcome all of the headwinds to the extent that we, and you, are accustomed. And in this regard, we, and I, are Starbucks' harshest critics. But before rushing to judgment on what one quarter's U.S. comp means, let's think back just 90 days to our Q2 call. Then, and following some slowing in Starbucks' China business, and specifically in comps and traffic, some were proclaiming the demise of our China strategy and perhaps our China business overall. Yet, here we are just 90 days later, approaching 2,300 stores in over 100 cities in China, opening more than one store a day and posting stunning Q3 results, including 7% comps, almost all of that growth coming from increased traffic. Again, demonstrating the strength, relevancy, and resiliency of the Starbucks business and brand in China.

As many of you have covered Starbucks for some time, you have seen us occasionally experience periods of slower growth in our U.S. business, only to see the business rebound with greater strength and vigor in the quarters that follow. This is precisely the pattern I personally believe you're going to see as we head into fiscal 2017 and beyond.

Perhaps the best evidence of the strength and resilience of Starbucks' business and brand is the robust performance of our newest class of retail stores, both in the U.S. and around the world. Record AUVs and record profits, with both growing and causing no net cannibalization of existing stores in the same trading area.

This consistently strong performance drove our decision to open 1,900 net new stores around the world and over 600 alone in the U.S. in fiscal 2016, a pace of new store openings that we will be increasing both in the U.S. and around the world in 2017 and beyond.

A few words on the great strides we made in Q3 against plans to expand our cold proprietary beverage platform and to elevate and further create premiumization at the very highest end of the coffee industry and create further separation from competitors. Our proprietary Cold Brew platform was nothing short of a runaway success in Q3, adding incrementality and driving attach, particularly in the afternoon daypart, and Nitro has been so well received in the stores it's in today that we are now accelerating the national rollout.

And we are delighted to announce the opening of two new Starbucks Roasteries, one in Shanghai opening in 2017 and one in New York opening in 2018. Both are now under construction. Just as with our Seattle Roastery, each of the Shanghai and New York Roasteries will showcase the newest coffee brewing methods and offer consumers the finest assortment of exclusive micro-lot coffees from around the world in a complete, immersive coffee experience like none in the world and advance our plans to build 500 plus new format coffee forward Starbucks Reserve stores in key markets around the world. And the new Roasteries will be offering an elevated artisanal food experience through our new exclusive relationship with the renowned Italian bakery and café operator, Princi.

In a few moments, Kevin will take you through individual segment operating performance in Q3 and provide some color around the positive momentum we are seeing as we enter Q4 and prepare for holiday, and he'll introduce you to personalization, our new one-to-one personalized marketing capability that I strongly believe will prove to be a retail industry game changer, unlocking even more digital flywheel potential and driving even more growth in our business in the quarters and years ahead.

Then Scott will take you through the financials in detail and provide Q4 guidance, and then we'll turn the call over to the operator for Q&A.

As we continue to work to achieve our aspirational goal of becoming a great, enduring company, we are reminded that Starbucks' greatest strength and its greatest asset remains its people. This has always been and always will be the case.

Credit for our ability to post record revenues, margins, and profits in Q3 over a very strong Q3 last year and still achieve the upper-end of our Q3 EPS target range, despite less than expected sales lift from our U.S. Retail business, goes to our dedicated in-store partners who continue to serve our customers with the warmth and welcome that are the unique hallmarks of the Starbucks brand and the experience. Our Starbucks partners have my respect and my appreciation for all they do each and every day.

And with that, I'll turn the call over to Kevin.

Kevin R. Johnson
President, Chief Operating Officer & Director

Thank you, Howard, and good afternoon, everyone. These record financial and operating results demonstrate the strength and relevance of the Starbucks brand around the world. This quarter was an anomaly, and while we are not pleased with the U.S. comp result, we understand the drivers and have a clear action plan already in motion.

Our Summer 2 marketing campaign launched earlier this month, and we are seeing positive customer reception. We are experiencing good early results from our personalized digital marketing, with more customer-focused enhancements to our mobile app in the pipeline, and execution across our seven core strategies for growth continues with progress in each initiative linked to growth.

On today's call, I will provide an overview of segment performance, update you on the Summer 2 campaign, and highlight some key digital flywheel initiatives. Let's start with the Americas segment. Our Americas business, with over 8,800 company operated and 6,400 licensed stores operating in 16 countries, delivered 4% comp growth on top of 8% comp growth in Q3 of last year.

This resulted in record Q3 revenues up 7% over prior-year. We're on track to open 750 net new stores in the Americas in fiscal 2016, and our new classes of stores continue to outperform and deliver record-setting profitability in AUV sales.

Our U.S. business delivered 4% comp growth and 8% revenue growth in the quarter. Howard highlighted the fact that the one-time transition to the new Rewards program in Q3 required marketing and field resources, which disrupted the normal cadence of our Summer 1 campaign and impacted Frappuccino momentum in the quarter. This was reflected in our same-store comparable with core beverages, excluding blended, contributing two points of comp, Food contributing one point of comp; and our Teavana and refreshment platforms contributing one point of comp each.

Overall, our U.S. business grew in every daypart with the morning being our fastest-growing daypart. Morning was driven by the combination of increased Mobile Order & Pay transactions, strong performance from our core brewed and espresso product line-up, and breakfast sandwiches, which grew 20% year-on-year. We continued to successfully execute our strategy of elevating and growing our cold beverage platform. Iced beverage revenues, excluding blended, grew 25% year-on-year. We expanded our Cold Brew coffee platform through the successful launch of the Vanilla Sweet Cream Cold Brew, and we're excited by the prospects for our cold coffee beverage lineup, including Iced Coconut Milk Mocha Macchiato, and Starbucks Nitro Cold Brew. Teavana handcrafted beverages continue to resonate with customers, as iced tea sales increased 30% in the quarter, led by Mango Black, Peach Green, and Passion Tango Herbal iced teas.

Our refreshment platform has also shown strong growth, up 50% over prior year, driven by the rainbow drinks phenomenon. The Pink Drink generated significant social media buzz and demonstrates the power of customer-driven innovation. Our Summer 2 campaign is now focused on the broader cold coffee and tea beverages, and we're off to a good start.

Our Food platform continues to build and drive attach. In Q3, Food grew 10% and contributed one point of comp. While the comp growth has slowed, Food is at a record 20% of total sales. We actually saw an increase in attach. Our new Power Lunch has been well received as a convenient, personalized lunch offering, which is increasing customer awareness of our lunch and snack options.

Let's now move on to China/Asia Pacific. Starbucks China/Asia Pacific region delivered another quarter of strong performance with year-on-year revenue and operating income growth of 18% and 22%, respectively. Comp sales in CAP increased 3% in the quarter, with China comp accelerating to 7%. Japan comps were positive but impacted by the recent earthquakes and ongoing economic challenges in the country. Profitability in Japan remains strong. We're optimistic about the long-term potential in the country. We now operate over 6,100 stores in 15 markets across CAP, including more than 2,200 stores in over 100 cities throughout Mainland China.

Noteworthy is that despite moderated GDP growth in China, Starbucks China business was very strong, particularly in our largest cities. The acceleration of comp sales to 7% in the quarter was driven by 6% transaction growth, reinforcing that we are reaching new customers, as well as increasing the frequency of existing customer visits. Our newest China stores continue to deliver record-breaking volume and profit, and we remain committed, and we're on plan to increase our store count to over 3,400 in China and to over 10,000 in CAP overall by the end of fiscal 2019.

Our loyalty program is the cornerstone of our digital flywheel, and CAP now has over 19 million Starbucks Reward members, with over 10 million in China alone. We recently launched mobile payment in China, leveraging the Starbucks mobile app with Starbucks stored value cards linked to Rewards. In Japan, we launched our first-ever Starbucks mobile app, giving customers the ability to pay for their purchases and send eGifts. We're extremely pleased by the rapid adoption of the mobile app in Japan. Our China/Asia Pacific business continues to perform well, reinforcing our confidence in the long-term growth potential of this market.

Let's now move on to EMEA. EMEA continues to execute against a strategy to achieve an appropriate balance between company-operated and licensed stores. This is enabling us to grow our store footprint more rapidly, while expanding underlying operating margin over time. While the reported revenue decline in EMEA was 7%, when you adjust for the transfer of company-owned stores to licensed stores and for FX, which together impacted revenue by 12 points, revenue growth was 5%. We opened 92 new stores in the quarter and we've successfully transitioned our company-operated stores in Germany to our licensed partner, AmRest. Following this transition, 79% of the 2,565 stores throughout EMEA are now licensed.

System comps across our EMEA business grew 2% in the quarter. A slow-growth European economy, Brexit, a weakened British pound, and ongoing security concerns throughout the region have contributed to consumer uncertainty throughout Europe. Our brand continues to hold up well in this challenging environment. We continue to see strength in the morning daypart from espresso growth and breakfast sandwich attach. In addition, the recent launch of the Teavana Shaken Iced Tea platform in Starbucks stores across 32 EMEA countries has exceeded our most optimistic projections. Featuring core beverages, including Peach Green Tea Lemonade, Classic Iced Tea and Iced Tea Lemonade available in black, green or hibiscus, the initial reaction from customers has been fantastic. We continue the global rollout of Teavana at Starbucks in most CAP markets later this quarter.

Let's move on to Channel Development. Channel Development had a very strong Q3, with sequential acceleration of revenue growth to 9%. Operating income grew by 31% year-on-year, with each of the U.S. CPG, international CPG, and foodservice channels contributing to these outstanding results. Both the Starbucks Roast and Ground and Starbucks K-Cup platforms grew dollar share and maintained share leadership in the quarter. Our K-Cups business posted a strong dollar share growth of 13.3%, which was almost twice the category growth overall and gained just under a full point of share. With a 15.8% share, Starbucks is the number one brand on the K-Cup platform for the fourth consecutive quarter. Starbucks Roast and Ground continues to be the number one premium packaged coffee brand, with dollar sales growth of 8%, also roughly twice the category growth in the quarter overall, and gained just under one full point of share. Once again, our foodservice business led the industry, posting 6% growth, driven by strength in sales from national customers and the Office Coffee channel.

Turning to Ready-to-Drink, our North American Coffee Partnership with PepsiCo posted excellent results in the quarter. System sales, as measured by IRI, grew 11%, translating into a 1% share gain, bringing Starbucks to 13.3% of the total liquid coffee plus energy segment. And we are very excited about the prospects for our new Cold Brew Ready-to-Drink coffee launched just this month. Premium Ready-to-Drink tea is the fastest-growing segment in the tea category, growing 16% CAGR over the past five years and now generating an addressable market of $1.1 billion in sales.

In Q3, we announced our entry into this new category through a new partnership with Anheuser-Busch. The Teavana Ready-to-Drink product line will offer consumers premium flavor options currently available to consumers only at Starbucks and Teavana retail stores. Teavana Ready-to-Drink teas will launch regionally in the first half of calendar year 2017 and expand across the U.S. over time.

We continue to build our global CPG footprint. In the quarter, we began shipping Ready-to-Drink products within Latin America in partnership with PepsiCo. In Europe, we are on track for a fall launch of Starbucks Nespresso-compatible capsules in the U.K. and France. In partnership with Tingyi, we are tracking to launch Ready-to-Drink products in China by the end of calendar year 2016. The Channel Development segment continues to perform extremely well.

Before handing over to Scott, I want to close with just a brief update on our digital flywheel. Having successfully navigating transitioning customers to the new program, we are now positioned to further accelerate program growth with a structure conducive to greater innovation and expansion. During the time of year when we typically see little, if any, program growth, we grew active membership to 12.3 million members. With strong retention across all customer segments, the vast majority of these customers now use our mobile app as the payment vehicle, accounting for approximately 25% of all transactions.

Mobile Order & Pay was deployed less than one year ago and now represents nearly 5% of total U.S. transactions, close to 20% of all mobile payment at Starbucks. But that doesn't tell the entire story. When you look at our busiest stores at peak, when Mobile Order & Pay is most valuable to our customers and most effective at unlocking capacity in our stores, we see an even more impressive trend. In more than 2,700 stores across the U.S., Mobile Order & Pay represents more than 10% of total transactions at peak. In several hundred of those U.S. stores, Mobile Order & Pay represents more than 20% of transactions at peak.

Adoption and usage continue to grow, and the upside is significant, as it is helping our customers and partners in our busiest stores at peak. We continue to make progress on app improvements that includes menu functionality and response time, while enabling new features, including favorite stores, favorite items, favorite orders, and personalized recommendations, most of which will be released over the next three months.

Over the next several years, we will continue to enhance and expand personalization, both in our app and in other digital channels. We are now driving personalized offers through e-mail, which are yielding extremely encouraging results. We are building a true, real-time, personalization capability which will begin to power personalized experiences and communications within our app. The digital flywheel is a powerful asset, with a clear innovation roadmap.

In closing, we have navigated the onetime event of transitioning to the new Starbucks Rewards program and our actions going forward are clear. Drive the Summer 2 marketing campaign around cold, enable the next wave of digital innovation and personalization, and continue to execute against our seven core strategies for growth.

I'll now hand over to Scott Maw to take you through the financials. Scott.

Scott Harlan Maw

Executive Vice President and Chief Financial Officer

Thanks, Kevin, and good afternoon, everyone. Starbucks' third quarter results, once again, reflect strong revenue and profit growth, although below recent trends. For the first time in our history, consolidated operating income exceeded $1 billion in a non-holiday quarter, increasing 9% over last year despite a full point of negative impact from foreign exchange.

Operating margin expanded 30 basis points to 19.5% on a GAAP basis, and 19.8% on a non-GAAP basis, both new Q3 records. Margin improvement was driven by sales leverage and favorability in cost of sales that more than offset the impact of ongoing partner and digital investments, primarily related to our Americas segment.

On a GAAP basis, EPS increased 24% to $0.51 in Q3, and on a non-GAAP basis, EPS increased 17% to $0.49. Noteworthy is that non-GAAP EPS in Q3 excludes the impact from the net gain resulting from the sale of our business in Germany to an existing licensed partner and an incremental tax benefit related to certain additional domestic manufacturing deductions for periods prior to FY 2016.

Additionally, non-GAAP EPS continues to exclude certain costs related to our purchase of Starbucks Japan discussed on prior earnings calls. You can see the amount, timing, and description of each of these non-GAAP items in the detailed reconciliation table provided at the end of the earnings release. Please review that table in conjunction with our results.

I'll now take you through the operating performance of each of our major segments in Q3. Americas' Q3 operating income grew to a new third quarter record of $899 million, a 5% increase over the prior year quarter. Operating margin, while declining 40 basis points year-over-year, remains strong at 24.6%. In addition to the details Kevin provided on U.S. comps, we did see nearly one point of transaction splitting impact during the quarter following the Starbucks Rewards launch. This is consistent with our previous estimate we provided and impacts both ticket and transaction by about one point.

Store partner and digital investments increased in Q3, impacting operating margin by 140 basis points. Included in that figure is 90 basis points of impact related to a $30 million onetime cash award for tenured U.S. Retail hourly store partners. The impact of these investments was partially offset by sales leverage and savings in cost of sales.

Given our Q3 results and outlook for Q4, we expect operating margin in fiscal 2016 for the Americas to increase slightly over fiscal 2015.

Let's move on to our China/Asia Pacific segment. Our China/Asia Pacific segment delivered its highest-ever quarterly operating income in Q3, $183 million on a GAAP basis, representing a 22% increase year-over-year, and an 80 basis point increase in operating margin to 23.8%, as the segment benefited from higher income from our joint venture operations and increased sales leverage, partially offset by a negative 130 basis point impact of foreign currency translation. Excluding the impact of foreign exchange, CAP margins expanded by 210 basis points in Q3. For the year, we now see CAP operating margins expanding slightly over last year, an increase from our most recent guidance given our strong operating performance in the region.

Let's move on to EMEA. EMEA's operating margin declined 130 basis points in Q3 compared to last year, to 10.9%, largely due to the sale of our Germany retail operations, driven by costs related to the sale of 110 basis points. While licensed store profitability continues to improve, EMEA is facing significant ongoing economic and geopolitical headwinds. As a result, we now see fiscal year 2016 operating margin roughly equal to last year.

Our Channel Development segment once again delivered very strong performance and results in Q3. Channel Development operating income reached a new quarterly record of $188 million, up 31% over last year, as operating margin increased 710 basis points in the quarter to 42.6%, driven primarily by favorability in coffee costs, lower marketing spend, higher income from our North American Coffee Partnership with Pepsi, and leverage on cost of sales.

Year-to-date, our North American Coffee Partnership has grown its operating income contribution by a remarkable 33%, reflecting strong demand for core bottled beverages such as Frappuccino and the success of innovative new products. Given the performance to-date, we now expect strong operating margin expansion for Channel Development with the full year 2016 in line with the segment's Q3 year-to-date margin.

I want to take a moment to comment specifically on our Q3 tax rate, because it came in lower than our expectation and yours. Our reported Q3 effective tax rate of 29.7% included several items worth mentioning. As noted in the non-GAAP reconciliation at the end of our earnings release, we recorded a true-up related to a specific domestic manufacturing tax benefit in the quarter, and also the net gain from the Germany sale, the majority of which was non-taxable. These items had a favorable 260 basis point impact on the tax rate. The remaining net favorability, which was not included as a non-GAAP adjustment, related to various other items that we recorded during the quarter. We do not anticipate that the benefit from most of these items will recur in Q4.

I'd like to cover in some detail our expected performance for Q4 given our Q3 results, particularly in connection with our U.S. Retail business and the impact of the 53rd week. For Q4, we are expecting GAAP EPS in the range of $0.53 to $0.54, and non-GAAP EPS in the range of $0.54 to $0.55 including the impact of the 53rd week that will add roughly $0.06 to the quarter. I want to underscore that the $0.06 is our best estimate of the 53-week contribution. Forecasting the impact of a single week out of a year with complete precision given the size and scale of our global business is challenging at best.

For our fiscal 2016, our GAAP EPS is expected to be in the range of $1.88 to $1.89, including the $0.06 for the 53rd week, and we are reiterating our non-GAAP EPS in the range of $1.88 to $1.89, including the $0.06 for the 53rd week, consistent with prior guidance. On a 52-week basis, non-GAAP EPS growth represents 15% to 16% over the prior year, our seventh straight year of at least 15% non-GAAP EPS growth.

We now expect global comp growth of 5% for Q4 and mid-single-digit comp growth globally for fiscal year 2016. This includes some anticipated improvement in Q4 U.S. comps from Q3 levels. On a 52-week basis, we now expect consolidated revenue growth of approximately 10%, with the 53rd week adding approximately two points and one point of negative impact from FX.

For the full year, foreign exchange is expected to negatively impact consolidated operating income growth by approximately two points. For fiscal 2016, we continue to expect investments in our partners and digital initiatives globally to be between $275 million and $300 million, compared to approximately $145 million in fiscal 2015. We continue to expect consolidated operating margin for fiscal 2016 to increase slightly relative to 2015 on both GAAP and non-GAAP bases, reflecting sales leverage and increased operating efficiency and performance, partially offset by the impact of increased partner and digital investments.

Moving on to commodities, with 2016 coffee needs fully priced, we still expect to see a slightly favorable impact for the year, and we are now over 50% price locked for fiscal 2017. We will update you on the projected 2017 impact of coffee costs in conjunction with our overall initial 2017 guidance next quarter.

Given the strong operating results we're generating from our new stores, particularly in our largest markets such as the U.S. and China, we now expect to add approximately 1,900 net new stores globally in fiscal 2016, up from our previous guidance, including 750 in Americas, 900 in China/Asia Pacific, and 250 in EMEA. I want to emphasize that we are seeing no change in the strong profitability or growth trajectory of our new stores. We now expect our effective tax rate for the year to be approximately 33%, and we still expect capital expenditures of $1.4 billion for fiscal 2016.

Consistent with the timing of targets for the current fiscal year, we will be providing our initial growth target for fiscal 2017 during our fourth quarter earnings call. You will recall that a year ago we made the decision to shift providing guidance to Q4 in order to have the time necessarily to fully vet and finalize our annual operating plan for the subsequent year.

As Howard mentioned, Q3 was an unusual quarter, characterized by very strong results from both China/Asia Pacific and Channel Development but challenged top line results in the U.S. due to less than expected sales lift from the launch of the new Starbucks Rewards program and Frappuccino Happy Hour and the high bar to clear from Q3 of last year. Yet despite this challenge and because of the dedication and commitment of our store partners around the world, we delivered another solid quarter and record revenues and profit.

Our path forward is clear. We are confident in the correctness of the strategic, operational and digital moves we outlined today, and remain steadfast in our commitment to deliver the long-term profitable growth that you have rightfully come to expect. We're looking forward to sharing more of our plans around reimagined store designs and new store formats, coming mobile, digital, and loyalty innovations, new food and beverage offerings, and the many other initiatives underway at our Biennial Investor Day on December 7.

Now I'll turn the call back to the operator for Q&A. Operator?

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from the line of Sara Senatore with Bernstein. Your line is open.

Sara H. Senatore
Sanford C. Bernstein & Co. LLC

Q

Thank you very much. Howard, I was wondering if maybe you could give some historical context. You've seen periods of weaker consumer confidence before. For me, the second quarter of 2012 kind of comes to mind and maybe late in 2014. And Starbucks has always been able to address it and re-accelerate comps. So could you maybe just talk about it in the context of what you're seeing now and your confidence in your ability to do that again similar to as you've done in prior years?

Howard S. Schultz
Chairman & Chief Executive Officer

A

Thank you for the question. You know, let me say that I think we've been very fortunate over the years to be able to create the kind of product and experience that provides our customers with a sense of community and an emotional attachment that I think, over time, despite the conditions in the marketplace and the economic pressures, have been very inviting for our customers. I say that because I think what we are experiencing to-date is something different. And before anyone rushes to judgment what I mean by that, let me explain it.

I think we have a situation where you have a very uncertain election. You have domestic civil unrest with regard to race. And I think the issues around terror have created a level of anxiety. And so, we're no longer looking at just an economic downturn. There are a number of things that we are facing as citizens, and I think the direction of the country.

And so, I think this is a multi-prong issue that almost every company and every consumer brand is facing as a result of what I've just described. As I said in my prepared remarks, though, we, at Starbucks, look at this not as an excuse but feel very strongly that what we offer our customers, the sense of community, the longing for human connection, a safe place, an affordable luxury and, obviously, the innovation that we have brought forth gives us the confidence that we will be the kind of company and the kind of brand that will demonstrate to our customers the aspirational connection.

And I think also it's very – I know this is a long-winded answer, but it's important. So much of what we've been able to do over the years is linked to the equity of the brand which is linked to the experience. That experience comes to life with our people. The investments we continue to make with our people are as important as anything we are doing to overcome the challenge and the headwinds that I've just described.

In addition to that, I think the social impact initiatives that we have brought forth over the last couple of years has created a level of trust and confidence in the brand, in the experience, I think, that demonstrates that our ability to navigate through this time and time again will give us the ability this time as well to put up the kind of numbers that Scott just described, and we will do everything we can to not only meet the guidance but, as we've done in the past, try and overachieve it.

But no one should misinterpret or in any way look at the challenges that we and many, many other companies are facing as something that has been done before. This is quite unusual. It's unsettling. It's unnerving, and as a result of that, it requires an approach that is quite different than anything we've done before.

But I must say that I'm confident that the team, the leadership, the field, the equity of the brand, the innovation, what Kevin has described in digital, all of these things, coupled with the offset of being able to create the kind of business in Asia, and specifically China, which gives us the ability to offset some of the concerns that are going on in the U.S. and create the kind of business in China that one day – and I've said this in the past – will be as large or larger than the U.S.

And as a result of that, we won't be as dependent on the domestic relationship we currently have. You look at the China business today, the growth, the revenue, the equity of the brand, the experience – for those people who haven't seen it, it's quite something to see after 17 years what we've been able to do there, and we are just getting started.

When that Shanghai Roastery opens, it's going to be something that is going to probably be as strong an experience as what Disney has done recently in Shanghai.

That's a very long-winded answer, and the short response is I am confident with cautious optimism that we will continue to be able to deliver despite the challenges I've just described.

Operator: Your next question comes from the line of John Ivankoe with JPMorgan. Your line is open.

John William Ivankoe
JPMorgan Securities LLC

Q

Hi. Great. Thank you so much, and I do apologize if I missed this but, Howard, it's been my impression with all of the exceptional things that you do at the store level that not everyone is aware of things like the benefits of my Starbucks Rewards, and even some of your core customers don't necessarily realize the benefits that they get from mobile ordering, given that 5% of transactions are currently mobile ordering. So everyone knows what Starbucks is in the United States, but is there an awareness opportunity for you to communicate directly, indirectly, in the Starbucks way, some of the key attributes that does make it different that perhaps gives us an opportunity as we think about 2017?

Howard S. Schultz
Chairman & Chief Executive Officer

A

Sure. One second. Here is Matt Ryan, who is going to take that.

Matthew Ryan
Executive Vice President, Global Chief Strategy Officer

A

Thank you, John, for the question. You're absolutely right. We do have an opportunity there. When we look over time, there are a lot of customers who are not aware of the benefits of the Rewards program. There are a lot of customers who have not joined it yet there. There are a lot of customers who don't know about Mobile Order & Pay and the tremendous benefits.

We're very fortunate that we have that in front of us, so we're leaning in constantly. We've seen a lot more recruitment of members in our stores this year. You're going to continue to see that, and you're going to continue to see us lean in hard on Mobile Order & Pay, continuing to improve the experience and showing people just how good it can be.

Operator: Your next question comes from the line of David Palmer with RBC. Your line is open.

David Palmer
RBC Capital Markets LLC

Q

Hi. Thanks. With regard to Food growth, you mentioned that it was perhaps not quite as strong as it was in previous quarters. Do you think you're reaching near-peak levels of Food attachment? Or is this just quarterly noise? And relatedly, from a menu composition standpoint, what do you think is perhaps the more exciting sales layers that you're pursuing currently? Thanks.

Kevin R. Johnson
President, Chief Operating Officer & Director

A

Yeah. This is Kevin, David, and then I'll hand it over to Cliff to give you some more background. I think we have not reached some level of saturation on how much we can grow Food. I think we've seen very good growth of our breakfast sandwich lineup. We're seeing increased attach of Food. I think if you look at each daypart, there are opportunities in every daypart for us to do more around Food, and I think we recognize that as one of our seven core strategies for growth and the work that we're doing, both in R&D and innovation and testing things in stores and markets, I think continues to present an opportunity.

We did see Food contribute one point of comp growth this quarter. I think in prior quarter I think it was at two points of comp growth. So we're still seeing good comp growth coming from Food, and there's more we can do there. Cliff, I'll let you add some more to that.

Clifford Burrows
Group President-Americas, US & Teavana Region

A

Yeah. Thanks, Kevin. And, David, it's great to see the strength and the continued growth on breakfast sandwiches, and that morning daypart just continues to get stronger and stronger. The opportunity is to provide choice, variety and a competitive approach around lunch and later dayparts. And we've started our journey, and if I remember back rolling out breakfast sandwiches I think took us several years, and the growth we've seen since we've brought in the baked goods at La Boulange and the enhancements to the quality and the choice of breakfast sandwiches gives me every confidence that we will continue on this journey, 20% of our sales now coming from Food, it's a great opportunity for the future, and we're working hard on it.

Operator: Your next question comes from the line of John Glass with Morgan Stanley. Your line is open.

John Glass
Morgan Stanley & Co. LLC

Q

Thanks very much. You recently announced that you were going to raise wages in the U.S. by between 5% and 15%. So I'm just wondering, I know you don't talk about 2017 yet, but it begs the question since you brought it up at least in discussing that, what is the cost of that in dollars? What are the expenses that roll off this year that might help offset that? And can you fund that kind of investment in the context of 15% to 20% earnings growth? Any help there would be greatly appreciated.

Scott Harlan Maw
Executive Vice President and Chief Financial Officer

A

Thanks, John. It's Scott. I think the first thing I would say is the vast majority of that investment that we announced recently was already in our initial plans for 2017. And both those investments and any other investments that we choose to do as we move into next year, we'll talk about during the next earnings call, but I want to make sure both the performance this quarter, the guidance next quarter, the investments we're making, there is no wavering in our commitment to deliver at least 15% EPS growth every year, and that is true for 2017. So we'll get into more specifics, but as comp growth reaccelerates, as we take a look at additional investments, as we lap over investments that we make this year, the sum of all of that will be at least 15% earnings growth.

Howard S. Schultz
Chairman & Chief Executive Officer

A

And let me add something qualitatively to that. Because of the degree of frequency that the average customer has to their core store, their home store, whether it's at work or at home, there is a relationship that is built between the barista, the manager, and the customer. And we know from our own research that anything that we can do that lowers attrition, that creates a relationship with our customers and the people who are proudly wearing the green apron, that performance that you've seen year in, year out, is directly related. So what we want to try and do is really get ahead of any federal or state mandate to be the employer of choice, whether we go back to the late 1980s with Bean Stock and healthcare, and what we've done in the last couple of years with college achievement, and now what we're doing now on wages, we want to try and do everything we can to share success, because we know that the brand of Starbucks is directly related to the experience in our stores and our brand, unlike almost any consumer brand or retail stores directly linked to the pride and the trust that our people have in the company.

Operator: Your next question comes from the line of David Tarantino with Baird. Your line is open.

David E. Tarantino
Robert W. Baird & Co., Inc. (Broker)

Q

Hi. Good afternoon. I have a clarification question and then another question. First, on the clarification side, when you say, Howard, that you have line of sight into comps improving, is that meant to be a signal that you're already seeing that in July? Or you're expecting that to happen in the balance of the quarter? So if you could help to clarify that, that would be great. And then I think there was a reference to better leveraging the new Rewards program as you move forward. If you could just elaborate on what you're planning there and if that's something we should expect to see in the current quarter or as we move into next year.

Howard S. Schultz
Chairman & Chief Executive Officer

A

I think it would not be responsible to comment on the first 21 days of the quarter with regard to where comps are, but I think those of you who have been covering the company all these years in our public life of 24 years, we do not have a habit of giving guidance that we don't believe we can achieve. So take it on face value that Scott said that comps are going to improve in the quarter, and we believe that's going to be true.

Kevin R. Johnson
President, Chief Operating Officer & Director

A

Yeah. And then, David, in terms of your question on better leverage of the Rewards program and the digital flywheel, I'll give you three dimensions in which I think we have an opportunity to better leverage that asset.

Number one is continued geographic deployment. We talked about what we did this last quarter in Japan and China as examples, and the more we take the Rewards program and the mobile app on our digital flywheel to other geographies, that's one way to leverage. The second is growing the number of customers that we have in the Rewards program, and Matt Ryan highlighted that as a big opportunity, and that's one piece of it. And then the third is the way that we deepen the engagement with the existing customers in the Rewards program, and that's done through a combination of the work we're doing around personalization, and it's also done through the work we're doing to incent things like a trial of Mobile Order & Pay. I think we've got some number of customers that have tried Mobile Order & Pay. And statistically, when we look at – once a customer tries Mobile Order & Pay once, it's a very sticky feature. Once they try it once, they start using it regularly. The vast majority of them do.

So those are three dimensions. And I'm going to hand over to Matt Ryan to talk a little bit more about the personalization work we're doing, but those are three dimensions that we are going to use to leverage that asset. And, Matt, to you on personalization.

Matthew Ryan
Executive Vice President, Global Chief Strategy Officer
A

Thanks, Kevin. I think the one thing I would add here is there's a direct linkage between the changes we made in our Rewards program and our ability to launch personalization moving forward. As you know, the past program only rewarded frequency. We couldn't reward any other behavior but that. We now have the opportunity, both in e-mail, which we've just begun, and this quarter, in our app, to do suggested selling. So we will be suggesting and making personalized offers within the context of our app that will allow people to see things that are right for them.

In the year to come, you'll see more of this in the context of ordering. So at the moment, when somebody is there, we'll be able to suggest items that are additional purchases and reward that with a currency that now rewards not only frequency but also spend. So connecting the dots there you can see how this will build on itself and give us leverage to drive the total customer sales.

Operator: Your next question comes from the line of Andrew Charles with Cowen & Co. Your line is open.

Andrew Charles
Cowen & Co. LLC
Q

Great. Thank you. I've noticed a heightened level of Star Dash e-mails since the MSR transition, and this obviously isn't Starbucks-specific as the whole industry's promotional intensity has increased. But I'm curious as you think about improved trends in 4Q, is this taking into consideration weaning off these promotions, or given the fragile consumer environment Howard noted earlier, if a heightened level of promotions remains necessary near-term? Thanks.

Matthew Ryan
Executive Vice President, Global Chief Strategy Officer
A

Matt Ryan here again. I that what I'd like to call attention to that what you're actually seeing are more personalized and relevant communications. So very late in the quarter, we turned on, what we call, one-to-one marketing. It's actually close to one-to-30, but we are getting down to the level of personalized rewards based upon what people actually will do and knowledge we have of that individual customer's behavior. Previously, we sent e-mails to very large segments of customers. Now, we're able to do it on a very targeted basis, and what that allows us to do is to be more efficient and more effective with our communications so that we don't have to peanut butter a broad discount. We can go in more selectively and offer just what's right to get the next incremental level of engagement with us.

Howard S. Schultz
Chairman & Chief Executive Officer

A

Let me add one other thing that I think is very important. If you think what the size and scale of the national footprint of Starbucks and the amount of stores we have, we've achieved something that is quite rare and unique, and that is we've achieved a level of ubiquity in terms of our scale and national footprint and, at the same time, without question, a premium position in the marketplace. That is as a result of a very disciplined and thoughtful view of how to build and maintain a premium brand.

What we saw this past quarter and, for that matter, even beyond that, was given the challenges that exist in the marketplace that we've all seen and discussed, there is a tremendous amount of discounting and promotion going on in the market where people are buying business. We do not want to be in the business of buying business. We do not want to discount or dilute the integrity of the brand. We know who we are. We know what our core purpose is. And we've got to play the long game and have faith and confidence in what we stand for in terms of the experience, the quality of the coffee.

What we keep talking about really internally is we want to take the equity of the brand and the position of Starbucks up. The premiumization of Starbucks is linked to the Roasteries and linked to this new format of stores that we are working on that you'll begin to see in calendar 2017 which is Starbucks Reserve which, in a way, is like a cousin in a smaller format of the Roastery. All of that will shine a halo on the brand, shine a halo on the experience, and we don't want to do anything that would dilute that halo by buying business or discounting, and we're not going to get in that game, despite the fact that so many other people are throwing that at us.

Operator: Your next question comes from the line of Jason West with Credit Suisse. Your line is open.

Jason West
Credit Suisse Securities (USA) LLC (Broker)

Q

Yeah. Thanks. Just going back to the kind of broader margin outlook here, you guys have made some significant investments in the partners and technology over the last two years. I think there's a perception out there that as you roll into next year, you'll be able to lap some of those investments and perhaps will give you some room to let a little more margin flow to the bottom line. Can you kind of address your thoughts on that perception that's out there? Is that the right way to think about it? Or are we just in the earlier stages of these types of investments and you expect them to continue into next year, particularly given the labor environment that we have today?

Scott Harlan Maw
Executive Vice President and Chief Financial Officer

A

Thanks, Jason. This is Scott. What we said in the past is the significant investment started in 2014. They ramped in 2015, and we increased them again in 2016. And I think that, as we look ahead to 2017 and we start to put together our plan, I think there will be another significant level of investment in our partners in particular. We announced some of those recently. They're vital to driving the right level of retention, the right level of customer execution, as Howard talked about. So I think looking forward to 2017, you can see – I can see another significant amount of investments and also on the digital front. So as you look at the things that Matt talked about, the ability to drive personalization, we see an additional opportunity there.

So I don't think we're in the early innings, but it will probably continue for a number of years as we continue to drive digital innovation and we continue to drive the right level of investments in stores and partners. But what I think is important is that doesn't have any impact on our long-term guidance of at least 15% earnings growth, 10%

profit growth, and as a result, margin expansion. I just think we're investing more of that margin into our core partner and digital investments.

Operator: Your next question comes from the line of Nicole Miller with Piper Jaffray. Your line is open.

Nicole M. Miller Regan
Piper Jaffray & Co. (Broker)

Q

Thank you. My question is just tell us more about Channel Development, but what I was hoping you would comment on is I know dollar growth was up 9%, but how does volume growth compare? And then I was looking back in my model and historically the fourth quarter for the past few years is the highest operating margin quarter. So is there any reason that wouldn't hold true for this year? And the final part of that is, is everything in that's been renegotiated or added in this quarter such that it's a sustainable peak? Or do you think just in any timeframe in the future, it could be even higher? Thank you so much.

Michael Conway
President, Starbucks Global Channel Development

A

Thank you, Nicole. This is Mike Conway. So you're right, the 9% growth actually is quite, quite strong. We're pleased with that, and I would say that the combination of our strong in-store execution, the strong distribution that we've been able to have, the strength in general that we're seeing in foodservice is all contributing to that.

As I look at volume, I'd say our volume growth was a little bit higher than that, but not much, and I think the combination of our base and promotive pricing has been able to deliver both the kind of margin expansion that we want to see as well as the share improvements that we would see.

As we look forward to the fourth quarter, we feel very good about the innovation that we have coming. We've got our Cold Brew that is coming in our ready-to-serve segment. We also have our new Caffè Latte launch that is in our K-Cup format. That is going to be launched in the fourth quarter. And then on a global basis, we have a lot of new initiatives that are coming, particularly in the ready-to-drink and single-serve segments with our Nespresso launch in EMEA. So we feel good about the quality of our growth in the third quarter and our outlook for the fourth quarter we also feel good about as well. And I'll let Scott take the margin expansion question.

Scott Harlan Maw
Executive Vice President and Chief Financial Officer

A

On the fourth quarter Channel Development margin, it will be the highest quarter again for us this year, and it will expand over last year's Channel Development margin and expand over this quarter's margin. There's a lot of good things, as Mike talked about, that will impact that quarter.

And what I would say to the second part of your question, Nicole, is we continue to forecast, as we move through time, margin expansion in Channel Development. It won't be 710 basis points very many quarters. This was unusual and excellent, but we do expect channel operating income to grow faster than revenue growth, and that will drive margin expansion as we move into 2017.

Operator: Your next question comes from the line of Joe Buckley with Bank of America Merrill Lynch. Your line is open.

Joseph Terrence Buckley
Bank of America Merrill Lynch

Q

Thank you. Can I take you back to the effects of the Rewards program on the quarter? If you could just walk through in a little more detail how you think it disrupted some of the other things you that may have typically done. And maybe tie into that just customer acceptance. I mean, I know the membership is up quite big, but just sort of customer acceptance of the new program.

Howard S. Schultz
Chairman & Chief Executive Officer

A

Joe, this is Howard. I think Kevin is going to take the bulk of the question. But I think ask yourself rhetorically, with 25 consecutive quarters of 5% or greater, if we did not have the confluence of the Rewards program and the Frappuccino launch at the same time, what would comps have been for this quarter? And I can tell you unequivocally that we know internally that this was an anomaly as a result of what I described in my prepared remarks. Now, we own that from an execution standpoint because we underestimated what would take place. But if any of that did not exist, the comps in the quarter would not have been before that we have outlined in the release. And I think as a result of that, we feel very comfortable that things are going to improve. Kevin?

Kevin R. Johnson
President, Chief Operating Officer & Director

A

Yeah. Let me build on that, Joe. I think there's three primary drivers behind our Q3 results in the U.S. business. First, we launched Starbucks Rewards in mid-April, which impacted the timing of our annual Summer 1 campaign, and that Summer 1 campaign is what kicks off and launches our Frappuccino Happy Hour season.

Now, in many ways, the Rewards launch went exactly as planned, with the vast majority of our customers excited about their ability to earn more rewards and with nearly 20% year-on-year growth in membership. Customers that could potentially be disadvantaged have not materially changed their behavior, and we're seeing increased lift in activity and early signs of success from the personalization efforts Matt described.

So the launch of Rewards required a significant amount of cross-company focus from our marketing teams, store execution, our digital teams, and this included specific training and marketing in our stores. We trained our store partners on Rewards programs so they could explain it, and educate customers, and help them through that transition. We used our stores to market and launch the Rewards program. And in order to make room in the marketing calendar to do this training and launch it in our stores and communicate it to customers, we delayed our normal Summer 1 campaign launch by one week. So we launched it one week later than we did last year. And so this resulted in a slower launch or start to the Frappuccino Happy Hour. So that's number one.

Second, and related, was the implication of having two major marketing campaigns, Rewards and our Frappuccino Happy Hour, running simultaneously. Let me give you some more context. Over time, we've seen a little bit of slowing in the afternoon and some of the blended products such as Frappuccino, but this quarter stands out with a negative 1% comp in blended. And as you know, Happy Hour is a significant event each May and makes that month the biggest month of the year for us in terms of total U.S. transactions. And because of the foundational importance of the new Rewards program and the need to connect with customers, we had to have the marketing message around Rewards and communicated and unfortunately having two major marketing messages running simultaneously, we didn't get as much traction behind Frappuccino Happy Hour. We didn't get as much social media buzz and that translated into not as many transactions.

So launching it a week later and then have having two marketing messages simultaneously were the contributors. And then I think the potential third aspect that we acknowledge but can't quantify is the overall impact of customer sentiment. Given the significant economic and geopolitical uncertainty in many parts of world, and we believe consumer confidence has weakened.

Now, industry-specific spending data for retail broadly, and for restaurants specifically would support that that's the case. And, we've navigated these situations in the past. And I think, as Howard articulated, this one may be a bit different. But, we think when we put these three factors together, this quarter was an anomaly. And I think that gives you a little bit of perspective and a little bit of color around the drivers. Cliff, do you want to add to that?

Clifford Burrows
Group President-Americas, US & Teavana Region

A

Yeah, Joe, it's Cliff. I think one of the things just to share, change is always difficult for both partners and customers. The frequency we have people coming into our stores and the relationship between the barista and the customer is absolutely key to our business. So we invested in a lot of fronts in making our partners ready for the change. The good news is we transferred and changed over the program virtually overnight. It was a very, very seamless transition.

Functionality is great and growing, and the personalization just gives me so much confidence for the future. The opportunity now for us is to grow the awareness of the program with the existing customers about the benefits and personalization will really help with that. And then continue to grow the number of members in the program, and I think Mobile Order & Pay ties nicely into that. And as Kevin – I'm sorry, as Howard outlined earlier, the year-on-year growth on active members at 18%, taking us to 12.3 million, just gives us great confidence for the future.

Operator: Your next question comes from the line of Matthew DiFrisco with Guggenheim Securities. Your line is now open.

Matthew DiFrisco
Guggenheim Securities LLC

Q

Thank you. Just a little bit of a follow-up on that also with respect to looking back on the comp and just trying to understand the going-forward trends. I know there's been some publicity about the 1% price increase or about a $0.05 per beverage to come, and being taken. And I'm just curious as far as the way I understand it, two points for the core beverages in this quarter, one point for Food, one point for Teavana, so we're assuming then no price in 2Q – in fiscal 3Q and all of the reported then sort of 1% price increase would be incremental going forward?

Kevin R. Johnson
President, Chief Operating Officer & Director

A

Yeah, Matthew, one correction I want to add to your comp bridge that you just went through. There was also one point from the refreshment platform. There's one point from Teavana and one point from the refreshment platform. And so, if you add that up and you look inside, there was also then the negative point for blended, and that's how you get the bridge.

Scott Harlan Maw
Executive Vice President and Chief Financial Officer

A

And what I would add to that, Matt, is Kevin's comp numbers include pricing for those categories. So on your broader pricing question, the first thing I want to make sure you realize is, as we take price, we look at very carefully using our elasticity models, as you know, we look at it by product, we look at it by geography, and we're very careful to be sensitive to significant changes to customer impact. We're really cognizant of that. And as we've done that over the years, including this year and the most recent pricing changes that we just made, we are not seeing any change in customer attrition. So that's not happening.

And then to your core question. As you know over the last few years, we've had one point to two points of price in our comps every quarter. This quarter, in the third quarter, will fall into that one point to two point price range, and the fourth quarter will fall into that one point to two point price range. So there's no acceleration of comp pricing in the guidance that I gave.

Operator: Your next question comes from the line of Karen Holthouse with Goldman Sachs. Your line is open.

Karen Holthouse
Goldman Sachs & Co.
Q

Hi. Thanks for taking my question. So I'm asking a little bit of the same question as you're looking from this quarter into sort of next quarter and then fiscal 2017. Where are the puts and the takes on the comp algorithm? Is it that Food can re-accelerate or particular categories or does a lot of it come down to this one-to-one marketing and more of a traffic or frequency-driven acceleration? Thanks.

Scott Harlan Maw
Executive Vice President and Chief Financial Officer
A

I'll start and then if Matt wants to add. From a product standpoint, the first thing that's going to happen is blended sales will rebound. We obviously don't anticipate another negative 1% comp from blended. In addition, as we look at the Summer 2 platform that Kevin talked about with things like Iced Coconut Milk Macchiato and Mocha Macchiato and the early results from that are quite encouraging. We've got a number of things on the product lineup, Card, Nitro Cold Brew, as well as acceleration of some of the features within Mobile Order & Pay.

So later this quarter, we'll get favorites of stores which will make it easier for people in New York and other dense areas to select and save favorite stores, favorite orders, makes it easier to save favorite orders. And when we look at broadly our innovation pipeline, digital product, things that we're doing in the stores with things like Nitro, marketing, there's just a significant amount of momentum already, and then that we have planned as we look forward. And as we get into 2017, the second part of your question, and Matt touched on this, we will further refine our personalization capability to have suggested selling one-to-one as you're building your order with relevant products based upon what you've ordered in the past, daypart, your preferences. So all of that is stacked up, and that's what makes us think we can get to 5% at least as we get into Q4 and try to accelerate as we go into 2017.

Howard S. Schultz
Chairman & Chief Executive Officer
A

There's one more I think significant opportunity. Cliff, do you want to talk about that?

Clifford Burrows
Group President-Americas, US & Teavana Region
A

Yeah, let me just talk, Karen, about a real opportunity that exists playing off or drafting off the work we've done at the Roastery here in Seattle, and that is an opportunity to elevate coffee to a new level within our stores. And that is showing up as a Reserve bar. And we've started to deploy Reserve bars and we will continue to grow that, and it will be a significant opportunity for us to elevate the handcrafted, the artisanal nature of the barista, and you'll start to see that showing up across the country. And that will introduce new beverages which are at a premium, and it will give customers an opportunity to try some of the incredible coffees that are roasted in our Roasteries, in our Roastery here in Seattle.

Operator: Your next question comes from the line of R.J. Hottovy with Morningstar. Your line is open.

R.J. Hottovy
Morningstar, Inc. (Research)

Q

Thanks. I had a follow-up question on the earlier question about better leverage in the Rewards program. Appreciate the geographic enrollment and personalization goals that you outlined as goals of better leverage in the program. But in the last quarter, you talked about opportunities such as the debit card, potentially the grocery store linkage and other partnerships like Lyft and New York Times as potentially a way to leverage the loyalty program. Just curious if we could get an update on that and the outlook for that the rest of this year and into 2017? Thanks.

Matthew Ryan
Executive Vice President, Global Chief Strategy Officer

A

Sure. Matt Ryan again here. We are actively at work on that. As you know, we've announced a significant partnership with Chase and there's a core product that we are just trying to figure out when to place on the calendar right now. We're not going to exactly commit to a date because we want to give it the right opportunity to launch across the next year.

We're very excited about that, because when Kevin talked about the leveragability of a spend-based program as opposed to a frequency-based program, it allows us to do these kinds of things like award people for everyday spend. And right now it's simply a matter of execution and when we can get it on the calendar and give it the justice that it deserves from a timing perspective.

Operator: Your next question comes from the line of Mark Astrachan with Stifel. Your line is open.

Mark Astrachan
Stifel, Nicolaus & Co., Inc.

Q

Yeah, thanks. And good afternoon, everybody. Wanted to ask about the global opportunity for expansion of packaged and single-serve coffee? And sort of the puts and takes of building it alone versus partnering with other folks? And then sort of related on the Channel Development business, how should we think about the ramp of the RTD coffee partnerships outside of the U.S. contributing to equity income going forward?

Michael Conway
President, Starbucks Global Channel Development

A

Thank you. Yeah, this is Mike. So as we look at our global opportunity for Channel Development, we've really focused on Ready-to-Drink as being the key driver versus packaged coffee, and a lot of that I think has to do with the strength that we've been able to create in our U.S. business with PepsiCo and the North American Coffee Partnership, and we think that's a more immediate opportunity.

And you're right, the success for us is finding the right partners across the globe, and we have essentially done that as we look across our major markets. So within EMEA, we have a partnership with Arla that is quite strong, and we're building our business there in key markets.

In Latin America, we just signed a deal with PepsiCo last year to strengthen the business within that region, and we're just starting to ship into new markets and into new channels within the region this quarter. And then within China/Asia Pacific, Japan and China being our key markets, we have key partnerships in Japan, which is our biggest market with Suntory, in Korea with Dong Suh Foods. And then, as we've talked, we have a partnership with Tingyi in China, where we are in the final phases of scaling up both the distribution and manufacturing so that we'll be in the market by the end of this year. So we feel good about the prospects for our Ready-to-Drink business across the globe, and we think that will be the really driver for Channel Development, at least in the near-term.

Operator: And that was our last question.

Durga Doraisamy

Director of Investor Relations

Thank you all very much for joining us today, and we look forward to seeing you on December 7 in New York City. Have a good afternoon, everyone.

Howard S. Schultz

Chairman & Chief Executive Officer

Thank you. Bye.

Operator: And this concludes Starbucks Coffee Company's 2016 third quarter fiscal year 2016 earnings conference call. You may now disconnect.