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Starbucks Corp. (SBUX)

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MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon. My name is Julie and I will be your conference operator today. At this time, I would like to welcome everyone to the Starbucks Company's Fourth Quarter and 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.

Mr. Shaw, you may begin your conference.

Thomas Shaw

Vice President, Investor Relations, Starbucks Corp.

Thanks and good afternoon, everyone. This is Tom Shaw, Vice President of Investor Relations at Starbucks Coffee Company. Thanks for joining us today to discuss our fourth quarter and fiscal 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 John Culver, Group President, Starbucks Global Retail; Cliff Burrows, Group President, Siren Retail; Matt Ryan, Global Chief Strategy Officer; and Michael Conway, President of Global Channel Development.

I'd like to remind everyone that our fiscal 2016 year had 53 weeks as opposed to the usual 52 weeks. This happens every six years as our fiscal year ends on the closest Sunday to September 30 and the extra week is reflected in our results for the fourth quarter. We'll be presenting our GAAP results for the 14-week quarter and 53-week full year, but some of our discussion will be on the non-GAAP basis, excluding the extra week. As a further reminder, non-GAAP earnings also continues to exclude certain costs related to our purchase of Starbucks Japan discussed on prior earnings calls. Please refer to the reconciliation table at the end of our earnings release and on our website at investor.starbucks.com to find a reconciliation of non-GAAP financial measures referenced in today's call with the corresponding GAAP measures.

This conference call will also 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 our 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. This conference call is being webcast and an archive of the webcast will be available on our website.

And with that, I'll turn it over to Howard Schultz. Howard?

Howard S. Schultz

Chairman & Chief Executive Officer, Starbucks Corp.

Thank you, Tom, and, Tom, welcome to Starbucks. This is your first conference call, wonderful to have you. And welcome to everyone on today's call.

Starbucks record fiscal 2016 financial and operating results highlighted by an 11% increase in global revenues, a 17% increase in non-GAAP EPS and record operating margins despite persistent economic, consumer and geopolitical headwinds and the significant investments we continue to make in our people and our business and once again demonstrating the power, relevance and resilience of the Starbucks business and brand. Today, Starbucks is delivering an increasingly elevated Starbucks Experience to over 85 million customers through our 25,000 stores in 75 countries every week.

The trust and confidence our customers have in the Starbucks brand is propelling our business forward in markets and channels around the world as never before. But our record performance does not yet reflect what may be the most important strategic developments since Starbucks first changed how the world consumes coffee. The initiatives we have underway that are elevating the Starbucks brand, transforming the customer experience and setting the foundation for the next wave of growth in our business, starting right now with holiday, with premiumization as a core defining theme.

On today's call, I will provide context around several of these initiatives and open a window on exciting new innovations that are coming to life and will begin contributing to our sales and profits this year, and increasingly more so in the quarters and years ahead. And Kevin will provide highlights of our Q4 and fiscal 2016 operating performance, and Scott will take you through the details of our Q4 and fiscal 2016 financial performance and share our 2017 performance targets.

Perhaps nowhere in the world has the Starbucks Experience come to life more powerfully and been embraced more enthusiastically than in China, a country we first entered 17 years ago. I personally observed this again firsthand on my visit to the market just two weeks ago. Starbucks stores in China are among our most elegant, efficient and profitable of any stores in the world, and China once again produced record revenues and profits and strong comp store sales growth in both Q4 and fiscal 2016.

There are countless examples over the last decade of western companies and consumer brands that have tried but failed to achieve relevance in China. Not only has Starbucks cracked the code in China, consistently delivering record operating and financial performance, but our newest class of Starbucks stores in China is delivering the highest AUVs, ROI and profitability of any store class in our history in the market. And we have created partner pride and a deep emotional connection among our customers and our partners in the Starbucks brand in China that rivals any market in the world. By building the foundation of our business in China carefully, methodically and respectfully, we are creating a growth and profit engine that will continue to accelerate for decades to come.

Now, as I have said before, we are doubling down on China. We currently operate roughly 2,400 Starbucks stores in 114 cities in China, and employ over 30,000 passionate partners. And because we have consistently invested ahead of the growth curve, we can continue to open over a store a day, a rate of growth that will continue or accelerate into the foreseeable future.

We now have over 500 stores in Shanghai alone, a city of over 24 million people, making Shanghai the city in the world with more Starbucks stores than any other, and we continue to add stores. We remain on plan to have over 5,000 stores in China by 2021, and I am convinced that given the trust our customers in China have in the Starbucks brand and experience, and the loyalty they show us every day, in time, we will have more stores in China than we do in the U.S.

These are the reasons we have chosen Shanghai as the city for our first international Starbucks Reserve Roastery. Roasteries define coffee premiumization and are the epitome of the Starbucks coffee authority and retail experience. And the portfolio of Roasteries we plan to open around the world will enable us to extend and elevate the Starbucks Experience and the Starbucks brand overall for decades to come.

Opening in late 2017 on Nanjing Road, among the busiest shopping destinations in the world, the Starbucks Shanghai Roastery will be a stunning, two-level, 30,000-square-foot experiential destination showcasing the newest coffee brewing methods and offering customers the finest assortment of exclusive micro-lot coffees from around the world in an immersive, all-center experience emblematic of our Seattle Roastery, respectfully curating through a unique lens that will make it highly impactful and relevant to our Chinese customers.

Starbucks business in China is only in its very early stages of development, but we are already ideally and uniquely positioned to grow and profit in this key long-term growth market as economic reforms take hold and the Chinese middle class grows ultimately to encompass over 600 million people. And following on the heels of the Starbucks Shanghai Roastery, we'll be opening Starbucks Roasteries in New York City and in Tokyo in 2018, and our first roastery in Europe in 2019 in a city to be announced early in 2017.

Our decision to aggressively but thoughtfully and strategically expand our portfolio of Roasteries is supported by the one-of-a-kind, ultra-premium Reserve experience our Roasteries deliver to our customers, and the accelerating outperformance against plan we are experiencing in our Seattle Roastery, where full-year comp sales increased a full 24% over the prior year, thanks in large part to a ticket that has grown to be four times the ticket of a typical Starbucks store. But in addition to elevating the Starbucks brand and customer experience, our Seattle Roastery has also become a working laboratory for breakthrough innovation that is driving new product introductions and contributing to results across the entire Starbucks ecosystem.

Nitro, for example, an innovative, new cold coffee beverage infused with nitrogen to create an ultra-creamy texture that has been enthusiastically embraced by our customers and is now being rolled out in coffee-forward markets across the country, was developed and tested in the Seattle Roastery. So too was Starbucks Affogato, our expression of a classic artisanal ice cream dessert infused with espresso, as well as handcrafted, proprietary Teavana iced teas and several other innovative new coffee-infused mixology beverages that are already showing great promise in test stores. Stay tuned.

As with Starbucks Seattle Roastery, our Shanghai, New York and Tokyo Roasteries will serve as the foundation for the exciting, new-format, coffee-forward Starbucks Reserve stores. Also offering customers a range of artisanal food items, we plan to open around the world in the years ahead. The first of these new-format stores will open in the U.S. in the second half of our current fiscal year.

And we are extending elements of the high-end roastery experience to include Reserve espresso bars in existing and new Starbucks stores as part of our plan to further elevate the overall Starbucks Experience. Customers' response to this initiative has been both very positive and very encouraging, as customers are trading up to premium espresso beverages.

Still at the heart of all we do is our store partners, the best people in the industry. The investments we make in our people and in our business over the long-term is what drives the results we deliver quarter to quarter. The culture, the values and guiding principles of our company have always defined the brand. Consider our Starbucks College Achievement Plan, now in its third year, the Starbucks College Achievement Plan, a program that offers all Starbucks partners working 20 hours or more per week are given a company-paid, four-year online college education through our association with Arizona State University. The program now has over 6,200 partners enrolled, and we will celebrate 1,000 college graduates by the end of 2017.

Partners participating in the College Achievement Plan have twice the retention rate and four times the promotion rate of our core U.S. barista population.

The incremental investment in both wages and benefits for our store-level partners that we began making two years ago have been right not only from the perspective of sharing success, but also from the perspectives of enabling us to support and elevate our partners, attract and retain the best people, provide measured improvement in service to our customers and deliver outsized returns to our shareowners, due in part to an employee turnover rate that is the envy of our industry. We demonstrated this again in Q4 and in fiscal 2016, difficult environments for retailers by any measure. Yet here we are once again posting record performance, 11% top-line and 17% bottom-line for the year. Scott will update you on the size of the timing of our partner and other investments shortly.

A few final thoughts before handing the call over to Kevin. Since its opening two years ago, our Seattle Roastery has become recognized as the most immersive coffee-forward retail experience in the world today, and it has cast a bright halo across the entire Starbucks brand and ecosystem. We knew from the start that the Roastery would introduce a previously unattained level of premiumization to the coffee category curated through the unique Starbucks lens. We also knew that the Roastery would support the development and rollout of Starbucks Reserve stores, a new retail format that we believe will deliver 2x the financial performance of a traditional Starbucks store and represent a new significant growth opportunity for the company domestically and around the world.

But what we are achieving is much more than that. It's innovation and aspiration for the entire company and the beacon for the next wave of transformation that will elevate the entire Starbucks Experience. The Seattle Roastery is at once a laboratory for invention and handcrafted beverages, theater for coffee and the design cornerstone for new experience, like Reserve bars that over the next few years we'll incorporate into thousands of new and renovated stores.

Given both the success of the Roastery itself and its impact on the entire Starbucks company, we see the opportunity over time for 20 Roasteries to 30 Roasteries in influential cities around the world, defining the way for 1,000 or more Starbucks Reserve stores, carrying through to Reserve bars in 20% or more of existing and new Starbucks stores. Together, these innovations will further deepen connection to our customers, increase AUVs, ROI and profitability, and drive incrementality through new premium occasions we currently do not capture.

I am reminded of early days at Starbucks when we could foresee the transformation of coffee consumption that started in Seattle and spread all over the world. The scale of the opportunity, the confidence in our capability and the early validation we have all point to the next wave of growth for our company. In my years at Starbucks, I have never been more energized about the opportunity that lies ahead, and it's why Roasteries, Reserve stores and the premiumization of the Starbucks Experience will be my personal focus as we set up Starbucks for long-term growth and success.

The Shanghai Roastery is just the next tangible proof of the innovation and the entrepreneurial DNA of the company as we take our customers in China on a magical carpet ride starting just a year from now. But you don't need to wait to see what's happening if you can't get to China, or, for that matter, Seattle, where we have our first Roastery. Please visit our new stores with Reserve bars at 10 Waverly Place, 9th and Broadway, Brookfield Place, and 85th and Madison in New York City or in Lake Forest, Illinois. You'll see for yourself how the experience is defining the transformation of these stores and the experience for our customers, and how accretive this will be for our brand and our business. Better yet, come to our Investor Conference in December where we will be showcasing the Roastery, the evolution of the Starbucks Reserve brand, and demonstrating the impact that each of these stores will have on the Starbucks Experience and the future transformation of the company.

I'll now turn the call over to Kevin. Kevin?

Kevin R. Johnson

President, Chief Operating Officer & Director, Starbucks Corp.

Thank you, Howard. Good afternoon, everyone. Starbucks' strong performance in Q4 capped off another record year for the company. In fiscal year 2016, we opened over 2,000 net new stores, which are outperforming the prior classes of new stores. We grew global same-store sales by 5%. And we gained share of at-home coffee and ready-to-drink down the aisle. We also advanced several long-term growth priorities that include new Roasteries, a new Reserve store concept, enhanced CPG growth platforms, and we continue to execute against our long-term commitment in China.

I believe these results demonstrate the value we are realizing from the investments we are making in our partners, innovation, and the digital flywheel. Our approach of investing for long-term value creation, while driving excellence in execution today, is enabling us to deliver results in a challenging operating environment while positioning our business for long-term growth.

Serving as a member of this leadership team is a privilege, and I want to take this opportunity to thank each of my partners for their passion, teamwork and focus. On today's call, I will share an overview of our Q4 segment performance, provide insight into the work we are doing to expand our customer reach and frequency, and update you on our upcoming holiday campaign. Let's start with our Americas segment.

Our Americas business, with more than 9,000 company-operated and 6,500 licensed stores in 17 countries, delivered 5% comp growth in the quarter, driving record Q4 revenues, up 17% year-on-year. Please note that all references I make to revenue on this call will be on the 53-week basis. AUVs for both our existing and newest class of U.S. stores reached record levels, giving us confidence in our decision to open approximately 800 net new stores throughout the Americas in fiscal 2017. This was where our focus on innovative new store designs, from express stores to Roasteries, elevating the customer experience, and innovative premium offerings, are paying off.

Drilling down, our U.S. business delivered record Q4 revenues, up 18% over last year. U.S. comps accelerated from Q3 and posted a 4% increase. Our U.S. comps included a 6% increase in ticket and a 1% decline in transactions resulting from a shift in customer behavior away from order splitting and towards order consolidation. This follows a foundational change we made to our Rewards program, taking it from a frequency-based to a spend-based model.

While neutral to revenue, we estimate the impact of order consolidation drove transactions down by approximately two points and ticket up by approximately two points. It's important to note that this conversion from transaction to ticket reflects customers choosing to put multiple items on one ticket rather than an actual decline in traffic in our stores. And this will persist in our comp results until we lap the transition to the new Rewards program.

Overall, our U.S. business grew in every day-part, with particularly strong growth in our morning day-part. Our core beverage platforms contributed approximately two points of comp in Q4. Beverage innovation drove another point of comp, with Coconut Milk Macchiato, Latte Macchiato, Vanilla Sweet Cream Cold Brew and Teavana Iced Berry Sangria. These are great examples of customers trading up to premium beverage offerings that differentiate the Starbucks Experience and create further separation from competitors.

Food contributed one point of comp in the quarter, led by continued strength of our breakfast sandwich lineup, up 17% over last year and 60% over the last two years. Lunch remains a significant opportunity as we amplify the strength of our Bistro Box platform through the Power Lunch offering. While we've made great progress around food in the lunch day-part, we believe there is a significant opportunity ahead.

Our digital flywheel momentum accelerated through Q4 and we have now enabled this digital flywheel to spin even faster with the launch of true one-to-one personalization. While still in the early days, personalized reward offerings have more than doubled customer response rates over previous segmented email campaigns. This translates to increased customer engagement and spend.

A few relevant metrics on Starbucks Rewards. Membership is up 18% year-on-year. Mobile payment now represents 25% of all transactions, up from 20% a year ago. Customers continue to embrace Mobile Order & Pay, which now represents 6% of transactions, reaching 7% in the month of September. To put this into perspective, approximately 3,300 of our stores are handling 10% of their orders at peak through Mobile Order & Pay. In 600 stores, Mobile Order & Pay represents over 20% of orders at peak, triple the number from last year. The data shows that Mobile Order & Pay is making a difference for both our partners and our customers. For customers, Mobile Order & Pay provides a simple, elegant ordering experience, enabling convenience when they want it and rewards them with stars along the way. For partners, Mobile Order & Pay reduces line congestion, enables a more efficient in-store operation.

We are continuously improving the Mobile Order & Pay experience with newly released functionality that presents our personalized offer directly on the front screen of the mobile app and allows the customer to save favorite stores, favorite customized beverages. And we have new features in the pipeline to be released shortly, including real-time, personalized product suggestions, and the ability to save favorite orders, and there's more coming. We are enabling these digital experiences to bring joy to our customers while driving business outcomes. These digital flywheel investments are core to elevating our brand experience and building for our future.

Let's move on to China-Asia Pacific. Starbucks China-Asia Pacific delivered another record performance this quarter, with year-on-year revenue growth of 29%. Starbucks China remained strong despite moderating GDP growth in China, and we remain committed to build at least 500 net new stores each year for the next five years.

Comp sales in CAP increased 1% in the quarter, with China's 6% comp almost evenly split between increases in traffic and ticket, demonstrating that we are both reaching new customers and increasing frequency in China. As we have previously indicated, CAP comps are more heavily weighted towards Japan, where comps were slightly negative but profitability remains strong. Japan comps in the quarter were impacted by ongoing consumer and economic challenges, as well as a tough compare over last year. As we navigate the near-term challenges in Japan, we remain very optimistic about the long-term potential in the country.

We opened 316 net new stores in CAP in Q4 and now operate over 6,400 stores in 15 markets across the region, including over 2,400 stores in 114 cities in China. As Howard mentioned, Starbucks stores in China are among the most elegant, efficient, coffee-forward and profitable stores in our global store portfolio. With loyalty as a cornerstone, we are extremely pleased with the growth and evolution of our digital ecosystem in CAP. Currently, 13 CAP markets of our 15 CAP markets offer a loyalty program and stored value card. 11 of those markets accept digital payment. We now have 20 million Starbucks Rewards members in the CAP region, with over $1 billion loaded on the stored value cards in FY 2016.

The momentum of our digital platform in the region is particularly evident in China where we now have 12 million members, just under half of whom are active Rewards members. Our China-Asia Pacific business continues to perform well, further reinforcing our confidence in the long-term growth potential of this market.

Let's move on to EMEA. The Starbucks brand remains strong in EMEA. Although reported comps declined by 1%, overall system comp grew at 4% for the quarter. EMEA's Q4 reported revenues declined year-on-year by 12%. However, after adjusting for the approximately 26% impact of the transfer of company-owned to licensed stores and for foreign exchange, EMEA adjusted revenues increased 13% year-on-year, this despite continuing economic, geopolitical and consumer headwinds throughout the region. We now operate in 43 markets throughout EMEA, and in FY 2016, we added 280 net new stores. In Q4, we opened 77 net new stores, all of which were licensed.

The mix shift toward a licensed model is enabling us to grow our store footprint more rapidly while expanding underlying operating margin over time. We introduced Teavana handcrafted beverages in Starbucks stores across 29 EMEA markets. Teavana has been very well received by customers, exceeding our most optimistic expectations. We're off to a good start in EMEA.

Let's move on to Channel Development. Channel Development had a very strong Q4, with revenue growing 14% year-on-year, driven by share gains in at-home coffee. The strength of the Starbucks brand and great execution by our channels team drove this result. Our K-Cup business posted strong sales growth and gained over half point of share. Starbucks continues to be the number one K-Cup brand for the fifth consecutive quarter.

Fall Blend, a seasonal favorite and the launch of Caffè Latte K-Cups including Pumpkin Spice, contributed to the strong results. Starbucks roast and ground coffee continues to be the number one premium packaged coffee brand, growing faster than the entire category, and gaining over one full point of market share in the quarter. In addition to being the number one premium coffee brand, Starbucks solidified its position as the number two brand in the total coffee category, with share increasing to 15.8%. Through our North American Coffee Partnership with PepsiCo, our Ready-to-Drink business performed well with double shot Frappuccino and chilled multi-serve, which enabled another point of share gain in the liquid coffee and energy segment.

We have added additional CPG growth engines to the pipeline. The first is our plan to bring premium Teavana Ready-to-Drink teas to the U.S. through our partnership with Anheuser-Busch. We will begin to launch regionally during the first half of calendar 2017. In addition, we are expanding internationally with the recent launch of locally manufactured ready-to-drink Frappuccino through a partnership in China. Tingyi has rapidly achieved distribution in over 35 major Chinese cities and although it is still early days, we are experiencing strong consumer demand.

In Europe, we recently launched Starbucks Nespresso compatible capsules in the UK and France and the early results are encouraging. Channel Development continues to perform extremely well with additional growth opportunities just getting started.

On to holiday. We are very excited about our holiday plans. We have a solid marketing plan in place where our stores transform to holiday red and the holiday cups return. We will introduce wonderful food and beverage offerings, an amplified Starbucks for Life campaign and a platform of beautiful Starbucks gift cards and merchandise. We will also introduce our first specialty Cold Brew Coffee for the holidays, spice sweet cream Nariño 70 Cold Brew, our Starbucks Rewards members can get a first taste of this new handcrafted beverage starting today.

A few final words before turning the call over to Scott. As a leadership team navigating the current environment, we are mindful of our responsibilities to deliver near-term results, build a foundation for our future growth and stay true to the mission and values that brought us to this point in our journey. I believe our fiscal year 2016 results reflect this mindset. I want to thank the more than 300,000 Starbucks partners around the world who proudly wear the green apron. No other company has the opportunity to touch so many lives and each day, our store partners show up committed to our mission and deliver a customer experience like no other. Each and every Starbucks partner helps bring our brand to life. For their commitment and hard work, they have my utmost respect and gratitude.

With that, I'll turn the call over to Scott. Scott?

Scott Harlan Maw

Executive Vice President and Chief Financial Officer, Starbucks Corp.

Thank you, Kevin, and good afternoon, everyone. Starbucks Q4 of fiscal 2016 was the most profitable quarter capping off the most profitable year in the company's history. Q4 EPS was $0.54 and on a 14-week non-GAAP basis it was $0.56 with the extra week contributing approximately $0.06. Excluding the extra week, our non-GAAP EPS in Q4 grew by 16% over last year, representing our 15th straight quarter of non-GAAP EPS growth of 15% or greater.

Please note that for comparability purposes, all remaining non-GAAP references on today's call will exclude the extra week. Our consolidated operating margin in Q4 came in at 21.5% on a GAAP basis and 20.9% on a non-GAAP basis, improving 90 basis points over last year's fourth quarter non-GAAP operating margin. Operating margin improvement was driven primarily by sales leverage and favorability in commodity costs that more than offset the impact of increased partner investments and certain additional G&A costs. For the quarter, consolidated operating income increased 27% on a GAAP basis and 13% on a non-GAAP basis.

I'll now take you through our Q4 operating performance by segment. Let's start with the Americas. The Americas segment delivered both record operating income of $1.1 billion, and operating margin of 27.6% driven by strong performance in our businesses across the region. Non-GAAP operating income increased 18% over last year to $988 million, while operating margin expanded 210 basis points to 26.9%. This improvement was primarily driven by sales leverage that was partially offset by partner investments.

I'd like to call out two specific additional items in the Americas results this quarter. First, you will note that we saw leverage on store operating expenses during the quarter compared to deleverage for the full year. This result was driven by several factors, including a somewhat lower run rate of partner investments in Q4, a comparison to higher relative partner investments last Q4, some salary and benefit true-ups during Q4 this year and improved productivity in the stores. This productivity improvement includes the impact of removing nearly 10% of transactions from the POS over the past year or so, 6% coming from Mobile Order & Pay and two points coming from order consolidation. Going forward, we anticipate that store operating expenses will again show deleverage, given the level of partner investments we have planned for 2017. Second, Americas operating margin in Q4 was favorably impacted by 60 basis points as a result of a favorable legal settlement recorded in other operating expenses.

Let's move on to China-Asia Pacific. Starbucks China-Asia Pacific segment also delivered record quarterly GAAP and non-GAAP operating income in Q4. Operating income increased 48% to $192 million, and operating margin expanded by 300 basis points. On a non-GAAP basis, operating income increased by 34% to $189 million, and operating margin expanded 250 basis points. This performance made CAP once again the segment with the strongest quarterly top- and bottom-line growth. Margin expansion in CAP was primarily driven by the transition to a value-added tax structure in China, increased sales leverage and higher income from our joint venture operations. This favorability was partially offset by a negative 150 basis point impact of foreign currency translation. Stiff currency headwinds made CAP's margin expansion in Q4 even that much more noteworthy.

Let's turn to EMEA. Despite a very difficult business environment, EMEA delivered the second most profitable quarter in its history. Operating income decreased slightly in Q4, driven by lower revenues from company-owned stores. GAAP operating margin in Q4 came in at 17% while non-GAAP operating margin came in at 16.2%, down 100 basis points from the prior year's record quarter. Foreign exchange impacted EMEA margins significantly in Q4 with margin actually expanding after adjusting for FX. This expansion resulted from the ongoing shift in our store ownership model to an increasingly licensed store point – portfolio, once again reinforcing the correctness of our EMEA store strategy.

As Kevin mentioned, Starbucks Channel Development segment continued to take category share in Q4 while also delivering record quarterly operating income and strong operating margin expansion. Operating income for the segment was $244 million, and operating margin was 47.1%. On a non-GAAP basis, operating income reached $230 million, up 16% year-over-year as operating margin increased 480 basis points over the prior-year quarter to 48%. This improvement was driven primarily by favorability in COGS, primarily coffee costs, and higher income from our North American Coffee Partnership with Pepsi.

Noteworthy is that Channel Development Q4 revenue growth excluding the extra week was 5%, somewhat lower than recent quarters driven by a very strong comparison in Q4 of last year. We are off to a strong start in Q1 of 2017 and anticipate revenue growth for Channel Development in the high-single digits for the current quarter.

Our consolidated and segment performance for the full fiscal year 2016 were equally as strong. For the year, Starbucks posted record consolidated operating income of just over $4 billion with an 80 basis point expansion in operating margin to 19.6%. On a non-GAAP basis, excluding the $0.06 for the 53rd week, EPS grew by 17% or nearly 19% after adjusting for approximately two points of impact from foreign exchange.

Non-GAAP operating margin of 19.6% reflected a 50 basis point improvement over last year's non-GAAP operating margin. The increase was primarily driven by sales leverage that more than offset approximately 70 basis points of increased costs related to partner and digital investments.

Consolidated revenue growth on a 52-week basis was 9% but reached 10% after adjusting for one point of negative FX impact. Drilling down into segment performance for the year, our Americas segment delivered 110 basis points of GAAP operating margin expansion and 80 basis points of non-GAAP margin expansion, driven primarily by strong sales leverage, partially offset by increased partner investments. For the full year, our CAP segment delivered 60 basis points of margin expansion to 21.5%. On a non-GAAP basis, operating margin expanded by 50 basis points to 23.1%. Noteworthy is the CAP margin expanded despite approximately 200 basis points of negative impact from the combination of foreign exchange headwinds and the last bit of impact from the Japan ownership change.

Excluding these two items, segment margin expansion was significantly ahead of expectation for the year, driven by strong store level profitability in both China and Japan. For the year, EMEA margin was 13.5% on a GAAP and non-GAAP basis and a decrease of 30 basis points from fiscal 2015, due primarily to the impact of foreign exchange. Excluding the impact of FX, EMEA margin expanded slightly as the continued shift to a licensed model drove margin expansion despite very challenging macroeconomic and geopolitical environments in the region.

Finally, for the full year, Channel Development operating margin reached 41.8%. Non-GAAP operating income grew 21% and margin expanded by 410 basis points, representing Channel Development's fourth straight year of margin expansion in excess of 100 basis points. We started the year planning to open 1,800 net new stores globally and ended the year with over 2,000 net new stores, showing the confidence we had both in our store development teams and in the profitability our new stores generate. In a time where most other retailers are cutting openings and increasing closures, we are prudently but confidently increasing our openings somewhat for next year.

Finally, our effective tax rate for 2016 was 32.9% compared to 29.3% in fiscal 2015, reflecting the impact of almost an entirely non-taxable gain in fiscal 2015 related to the Starbucks Japan acquisition. The strength and health of our business enables us to continue generating significant operating cash flow to both fund profitable growth opportunities and return significant amounts of cash back to shareholders. We returned a record of approximately $3.2 billion to shareholders in fiscal 2016 through dividends and share repurchases, a 33% year-over-year increase. And today, we announced that our board has approved the 25% increase in our quarterly dividend to $0.25 per share.

Looking ahead, we remain confident in our ability to deliver strong performance and profitability. Here are the relevant targets for fiscal 2017. Consistent with our long-term guidance range, we expect global comp growth in FY 2017 to be in the mid-single digits range, with the first half of the year towards the lower end of that range and some improvement during the second half of the year within that range. Complementing our expected comp growth will be the addition of approximately 2,100 net new stores globally, up slightly from 2016, with 60% of planned openings outside the U.S. The Americas segment is expected to add 800 net new stores, split roughly evenly between company-owned and licensed.

Our China/Asia Pacific segment will drive almost half of our global new store growth at approximately 1,000 net new stores, two-thirds of which will be licensed. And our EMEA segment is targeting approximately 300 net new stores in fiscal 2017, virtually all of which will be licensed. These factors contribute to expected revenue growth of approximately 10% compared to fiscal 2016 on a 52-week basis.

Consolidated GAAP and non-GAAP operating margin is expected to improve slightly from 2016 on a 52-week basis, reflecting strong revenue growth and leverage on cost of goods sold and G&A partially offset by the impact of increased investments for retail store partners and digital investments. We expect partner and digital investments to increase by approximately $250 million versus an increase of approximately $160 million in 2016. The bulk of these investments will be in the U.S. and driven by increased partner wages and benefits. We also expect to make investments in our major markets around the world including paving the way for global expansion of our digital flywheel and increases in certain partner benefits such as housing allowances in key markets.

Let me pause to put our increased partner investments in relation to our earnings growth in 2017 into proper perspective. Last year, we increased investments by about $160 million and delivered non-GAAP EPS growth of 19% when adjusting for 2 points of negative FX impact. This year, we are targeting about $250 million of incremental investments and we are still planning to deliver non-GAAP EPS growth of 15% to 16%. Given the strength in our businesses across the globe and ongoing efficiency opportunities in our supply chain and G&A cost structure, we are confident that we can deliver on our targets while appropriately funding our investments.

Looking at our segments, we expect our operating margin in the Americas to be flat to up slightly relative to 2016, reflecting sales leverage and increased operational efficiencies but offset by the impact of increased investments. We expect moderate operating margin expansion in CAP with FX negatively impacting this segment a bit again in 2017. Operating margin in EMEA will approach 15% for the year as we continue to optimize the portfolio and realize the benefits of the ongoing business model shift from company-owned to licensed stores. And our Channel Development segment will again drive moderate margin expansion versus prior year, though less than the very strong 410 basis point expansion we saw in 2016. All of this segment margin guidance I just shared is on a 52-week non-GAAP basis.

Given all of these inputs, we expect fiscal 2017 GAAP EPS in the range of $2.09 to $2.11 and non-GAAP EPS in the range of $2.12 to $2.14. Specifically looking at Q1 2017, we are targeting GAAP EPS in the range of $0.50 to $0.51 and non-GAAP EPS of $0.51 to $0.52, representing a somewhat lower year-over-year growth rate than the full year. This dynamic is driven by the significant Q1 ramping of the partner investments we announced this summer.

Neither FX or commodities are expected to have a major impact on year-over-year profit growth, with FX slightly unfavorable and commodities slightly favorable. We have our coffee needs about two-thirds price locked for FY 2017. We expect our effective tax rate for 2017 will be about 34% and capital expenditures will be about $1.6 billion.

As I said at the outset, Starbucks fiscal Q4 capped off a record year for the company, performance that was particularly noteworthy, as it was delivered in the face of strong FX headwinds and challenging economic, consumer, and geopolitical environments in many markets around the world in which we compete. And as you can see, each of our segments contributed to our performance in the quarter and year in a meaningful way. We are producing industry-leading returns on our capital and investments while increasing our cash return to shareholders. Once again, credit for our success goes to our store partners around the world, whose dedication and commitment to delivering an elevated Starbucks Experience to our customers enables us to consistently deliver the results we do. We're looking forward to sharing more of our future plans with you at our upcoming Investor Day.

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

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Our first question comes from the line of Andy Barish from Jefferies. Andy, your line is now open.

Andrew Marc Barish
Analyst, Jefferies LLC

Q

Yeah, just wondering on the U.S. comp and the round-down. Did you see sort of some of the afternoon pressures and Frappuccino declines as the summer went on with your summer beverage program? Or did things get a little bit better there and you kind of have some products that can maybe pick up the slack for Frappuccino?

Kevin R. Johnson
President, Chief Operating Officer & Director, Starbucks Corp.

A

Yeah, Andy, this is Kevin. First of all, we saw growth in every day-part in the U.S. this last quarter. And Frappuccino contributed a bit of comp. So, from the weakness we had in Frappuccino in Q3, we saw positive contribution towards comp from Frappuccino in Q4.

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

Eric Gonzalez
Analyst, RBC Capital Markets LLC

Q

Hi. Good evening. This is Eric Gonzalez in for Dave Palmer. I think you said your mobile payment mix is about 25% during the quarter. I think this implies that, similar to last quarter, I think they have flattened out on a sequential basis. Have you analyzed why this might be? And do you think that there's steps you could take to jumpstart the growth in that mix?

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

Yeah, this is Kevin. First of all, the order consolidation impact has an impact on this as well. Keep in mind, this is 25% of transaction paid for with the mobile app. And so, with the order consolidation, you have customers actually doing more spend on the mobile app, but the number stays the same. And I think late in the quarter, we've seen that tick up 26%. So you have – the big contributor, though, was the order consolidation that impacted that.

Operator: And your next question comes from the line of Sara Senatore from Bernstein. Sara, your line is now open.

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

Thank you. I wanted to ask about the Roastery and the Reserve stores. And I guess the halo you mentioned. Can you talk perhaps about anything you're seeing in terms of customer perception that you might track? And I guess for those of us in New York, we see a lot of these so-called third wave coffee shops opening up. So is this sort of a beachhead for Starbucks against that? Are you not seeing an impact from that? Just wanted to get a sense of what the Roasteries and the Reserve stores are doing for you. Thank you.

Howard S. Schultz A
Chairman & Chief Executive Officer, Starbucks Corp.

Thank you. Sara, can I just ask you, have you seen the Roastery in Seattle? Have you been there?

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

I have.

Howard S. Schultz A
Chairman & Chief Executive Officer, Starbucks Corp.

Okay. Would you agree with me that you've never seen anything quite like that?

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

It is magical. That is an accurate assessment.

Howard S. Schultz A
Chairman & Chief Executive Officer, Starbucks Corp.

Okay, all right. I guess if you're a lawyer, you're never supposed to ask a question you don't know the answer to, so I took a little risk there. But I think anyone who has seen the Roastery understands that in addition to it being the kind of coffee experience, it has really no peer in terms of any retail experience. But all along, we set out to build a new brand and that was Starbucks Reserve, with the understanding that we had an opportunity to elevate the core business and really take the brand and the coffee up to a new level. Now, many of us have seen this take place in other industries, the fashion industry, the automobile industry, I think a good analog is what Nike's been able to do with Air Jordan and that is build a profit center and a sub brand that unto itself is a growth engine and, as a result of that, shines a halo on the entire company.

Now the Roastery itself has created the kind of retail experience that we are learning a great deal from. And the primary thing we're learning is that the Reserve bar, which in our parlance, that's the espresso bar and where all the coffee is made in multiple brewing methods, that has created excitement, interest, education, romance, theater, but it also has created the opportunity for us to provide our customers with a different coffee experience and, candidly, at a higher ticket. And so, we're taking learning from that and we're integrating that into existing and new Starbucks stores.

Those are the four stores that opened in Manhattan. They've opened in Lake Forest, Illinois. They've opened in Japan and China. And what we're seeing is the core Starbucks customer is coming into the store, and as a result of seeing Reserve and getting educated, they're taking their cue from the Reserve bar and the presentation and they're moving over to the Reserve bar and now purchasing espresso-based beverages that are more exotic, different taste profile, higher ticket, and obviously that shines a halo on the Starbucks Experience. Now, the big opportunity, in addition to that, is we believe that given the fact that the Roastery is only going be in 10 markets, 20 markets, 30 markets over the next number of years, the question is how do we scale the Reserve brand and how do we make it more accessible to our customers?

So we have been diligently working on a new store format and that new store format is Starbucks Reserve stores. And basically, if you can think about it this way, it's a 3,000 square foot store that has the design, the elegance, the materiality and all the romance without roasting in the store with artisanal food that we're bringing from Italy that we talked about in the last call, that's Princi. And those stores will begin opening in the second half of the year. So the Reserve brand, the pyramid starts with the Roastery. It goes to the Reserve store and then goes to the Reserve bar. As I said in my prepared remarks, we think that we're sitting on an opportunity to not only elevate the equity of the brand but drive incrementality in existing Starbucks stores and create a new growth platform for the company domestically and internationally. And, most importantly, take the company up.

But the short answer to your first question is this is not in response to any so-called third wave coffee, this is in response to the fact that we have a customer base of almost 90 million strong. And we know that our customers have given us license and have the trust in us to elevate the experience, and the Roastery is a proof source that we're onto something that we can scale and create a national and a global footprint as a result of it.

And the last piece of this is we're now selling Starbucks Reserve whole bean and ground coffee in existing Starbucks stores, and this is just the beginning of leveraging multiple channels of distribution under that brand.

Operator: Our next question comes from the line of John Glass from Morgan Stanley. John, your line is now open.

John Glass
Analyst, Morgan Stanley & Co. LLC

Q

Thanks very much. It seems that membership in My Starbucks Rewards is sort of the beginning of the funnel, you get consumers in at these mobile payment, mobile ordering, and yet I'm always surprised at how few people are actually members when I talk to friends, families, whatever, the members of the program. So how do you accelerate that? And I thought one of the reasons that you were changing the point system was enable to use the points outside – or the Stars outside of the Starbucks stores. We haven't heard much in terms of new alliances, for example, to broaden that to people who may not have been Starbucks customers become members through other organizations or affiliations you may have. Where do you stand on that process?

Matthew Ryan
Executive Vice President, Global Chief Strategy Officer, Starbucks Corp.

A

Thank you, John. Matt Ryan here. First of all, we see this as an enormous opportunity moving forward. We know that very few of our customers, relatively speaking, have become members. And that, to us, represents an enormous opportunity moving forward. What we do know is that when we are able to convert somebody into being a member of the program, we see tremendous incrementally as they join the program. And we continue to see that accelerate. Over the past few months, we have worked on successfully transitioning our program to a spend-based program, and we are now seeing the uptick in spend per member and engagement that we anticipated from the launch of the program. So we're completely on track and accelerating in that regard.

Our next big opportunity moving forward, especially in the natural window that we have ahead of us in the next two quarters is to take advantage of the traffic we see, the card volume we do to convert even more people into Starbucks Rewards.

And just on the topic of extending outside of Starbucks, it's never been our intention to have Starbucks Stars be used at other venues. But we are going to be giving customers the opportunity to earn Stars at other venues, starting with a partnership with Chase, which we previously announced.

Operator: Your next question comes from the line of David Tarantino from Robert W. Baird. David, your line is now open.

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

Q

Hi. Good afternoon. Scott, I wanted to ask about the guidance. I know you mentioned that you expect mid-single-digit comps for the year and perhaps a lower part of that in the first half of the year and the upper part of that in the second half of the year, if I heard you correctly. So could you just talk about what you might be trying to signal there about the first half of the year? Whether it's kind of more of the same versus what we've been seeing in the recent quarters? And then maybe talk about why that would be the case? Is it just comparisons? Or are you thinking there's certain initiatives that start to kick in in the second half of the year that will help the comps?

Scott Harlan Maw
Executive Vice President and Chief Financial Officer, Starbucks Corp.

A

Yeah, thanks, David. I think I would start with the fact that Howard covered around the environment that we're facing right now in many of our major markets around the globe. So the consumer remains under pressure in many places in Europe and Asia as well as here in the U.S., economic uncertainty around the overall consumer environment, around the election, that continues to weigh on our customers around the globe. And I think we can see that continuing as we get into 2017.

And then I would point to the fact that the comparisons that we had over the last couple quarters have been particularly difficult and impacted our comps that we reported in Q3 and Q4. And those comparisons, if anything, they get a little bit tougher as you get into Q1 and certainly stay as tough in Q2. So that weighs into the guidance.

And then the third thing, perhaps the most important thing is, we do have a number of initiatives that we'll be rolling out and accelerating over the course of the year. And we're going to spend a lot of time talk about this during Investor Day, but they include innovation around store development and store design, even beyond what Howard's talking about in Reserve focused stores.

But as we go through a pretty significant cycle of remodels, we see ways to do those remodels to both improve the customer experience as well as our partner experience and productivity. When you get on the digital front, Kevin talked about some of this, but we just launched Favorites from an item standpoint and from a store standpoint. I'm sure John you've used the Favorite stores. It's so much easier if you're in a dense, urban area that to pick among your stores and save them and quickly get what you want.

Same thing with Favorite items for highly customized beverages. So that's just rolling out. And over the next couple of quarters, we'll get to suggested selling, where as the customers building their order in the app, we'll be able to make relevant product suggestions to them. So that's all coming. Then product and food or food and beverage innovation is coming. Kevin talked about holiday. As we get into the new calendar year, there's a number of things that we'll talk about on the food side that we'll sample at Investor Day. So I think as we look into calendar year 2017, there's a number of things that make us a bit more optimistic that we might be able to get in the middle of that mid-single-digit range versus I think the first six months or so it will be towards the lower-end of that range.

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

Andrew Charles
Analyst, Cowen & Co. LLC

Q

Thank you. Can you walk us through how that 1% headwind from transaction splitting in 3Q widened to the 2% in 4Q? It's basically implying that there's going to be with one person used to do three transactions or two people used to do three transactions consolidating that into one. I understand the benefits obviously of the program and why that would normally happen but I guess I'm curious about why that widened?

Matthew Ryan
Executive Vice President, Global Chief Strategy Officer, Starbucks Corp.

A

Sure. It's Matt Ryan here. Let me take a stab at trying to answer that. It's a little bit complex so bear with me here. What we are seeing is basically how we record the transactions of customers in our stores and what we had in the past, but we didn't necessarily have visibility to, are people or parties of people coming in and buying multiple items. We could predict and forecast based upon what we saw on a singular account, somebody coming in and buying something and then right away using the same account again to buy something else. And that accounted for about 1 point of, what we call, transaction splitting going away. But what we were able to see through the end of the second quarter, especially as people adjusted their habits, was that there was actually consolidation taking place between multiple accounts.

And, of course, there would have been no way for us to see that before. But what we saw were multiple beverages being put on Starbucks Rewards accounts where they hadn't been put on there before. When you roll that all up together, what that means is we had two total points of what had been recorded on separate accounts before, now being consolidated onto a single account. So while the actual traffic wasn't any different, we're seeing consolidation of two points when you take both of those things into consideration.

Scott Harlan Maw
Executive Vice President and Chief Financial Officer, Starbucks Corp.

A

I'd just add one thing to what Matt said. We started to see that in beverage attach, so as we got into the summer we had the point that we expected but when we looked at beverage attach that really started to increase significantly and that's when we knew that multiple accounts were putting beverages on a single transaction where they were splitting it before.

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

John William Ivankoe
Analyst, JPMorgan Securities LLC

Q

Hi. Thank you. Howard, I was going to ask you to maybe apply the current environment in terms of what we're seeing both in the U.S. and around the world in the consumer environment, to what you've seen elsewhere in your decades of experience at Starbucks. And I guess a lot of us who are on the call are wondering if the environment can actually get better from where we are today. And as you kind of think about the election and getting that behind us, whether there's kind of an opportunity for the overall consumer sentiment in spending and the external environment perhaps being more of a tailwind than a headwind that's been in the last couple of years.

Howard S. Schultz
Chairman & Chief Executive Officer, Starbucks Corp.

A

John, I wish I was as smart as you might expect me to be. I mean I think we're asking ourselves the same questions that you have just posed. And also I think as we get around our table and we talk about the business, if you were in the room you'd hear us talking about the fact that we don't want to use weather and we don't want to use the uncertainty in the election as an excuse. But nevertheless, we are all trying to navigate through a difficult time. I mean I would label this time as just a high degree of uncertainty that obviously is domestically driven but has affected the rest of the world. John and I and Cliff just last week we're in China and Japan, and Cliff and I will be in Europe next week, and I think it's safe to say that wherever we have been, I don't think we've ever witnessed such concern about what could happen in the U.S. as a result of the election.

And I think there's no question, as I speak to other retailers and other merchants both in and out of our sector, that there isn't one exception where everyone is experiencing, I think, a very unpredictable and erratic chain of events where it's very, very hard. I think what's equally hard, it's very hard to cut through all of the noise and try and get access to the customer and try and get your message out.

So I think we've tried to be very disciplined and very thoughtful about how we spend our money, both in traditional advertising and social media, so that we are not in any way kind of getting caught into all of this. I think everyone is hoping that post the election, there will be a return to a natural state of affairs in terms of the consumer behavior. But I think there's another issue on the table that we have not yet discussed that I talked about three years ago, and that is the seismic shift in consumer traffic.

I was talking to Fred Smith just a couple of weeks ago about his situation at FedEx and he shared with me a piece of research which showed a significant drop in foot traffic on Main Street and in malls, not only domestically and around the world, as a result of e-commerce, the Web, and what I'll loosely describe as the Amazon effect. As a result of that, you're certainly seeing large companies and small companies not only not open new stores, but announce closures.

And let me just speak to that. I know this is a little long-winded but I think it's important. There's no doubt that over the next five years or so, we are going to see a dramatic level of retailers not be able to sustain their level of core business as a traditional bricks-and-mortar retailer, and their omni-channel approach is not going to be sustainable to maintain their cost of their infrastructure. And as a result of that, there's going to be tremendous amount of changes with regard to the retail landscape.

We believe, as we look down that pipe and look at the future, that our ability to maintain our growth in terms of new stores domestically and internationally, coupled with the fact that Starbucks still maintains a very special place in terms of a sense of community, the third place environment, and people looking for and seeking out human contact and a place to go, that as these store closures occur, and they will, that we are going to be in a very unique position five years, 10 years down the road because there's going to be a lot less people competing for those customers. I'm not talking about the coffee category; I'm talking overall.

But we are in the very, very early stages of a tremendous change in the bricks-and-mortar footprint of retailers domestically and internationally as a result of the sea change in how people are buying things, and that's going to have, I think, a negative effect on all of retail. But we believe that it's going to have ultimately a positive effect on the position that we occupy and the environment that we create in our stores.

So short answer, I think we got to get through this uncertainty. We're playing the long game in everything we do and we're going to continue to do everything we can to win the hearts and minds of our customers and invest in our people, and really, I think, create a breakthrough innovation as a result of what we're doing with the Roastery and other things. And just one thing about the Roastery. As New York and Shanghai opened, for those of you who have seen Seattle, I'll tell you that Shanghai and New York will be 2.0 as good as Seattle is. Wait until you see what we're going to do in New York and Shanghai. I mean, it's going to change the company, the brand, and everything we do.

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

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

Q

Yeah, just two quick clarifications and a question. Just one, Scott, on the guidance on the investments. Just to be clear, that $250 million is incremental to the $160 million? It's not $90 million over the $160 million? And then on the coffee outlook, can you just say if that's kind of looking flat or up or down for next year on what you have locked? And then the bigger picture question is just on the disruption I guess you saw last quarter when you switched the loyalty program, and people getting used to that new structure. Do you think there's still some disruption there that needs to get worked through or has that been sort of fully understood and people moving forward now with that?

Scott Harlan Maw
Executive Vice President and Chief Financial Officer, Starbucks Corp.

A

Thanks, Jason. I'll take the first couple and then I'll pass it over to Matt. The $250 million is incremental, so it would be on top of the $160 million. And then we see coffee a little bit favorable year-over-year. But as I mentioned in my prepared remarks, it's pretty much offset by slightly negative foreign exchange impact.

Matthew Ryan
Executive Vice President, Global Chief Strategy Officer, Starbucks Corp.

A

Great. And as for the disruption, a couple of key things. I think we're through with anything you might characterize as disruption, but I want to be careful with what I mean there. Number one is that we saw no attrition from the so-called disadvantaged people. We studied this issue very carefully and tracked it all through the summer, and we did not see those people who are not earning Rewards as quickly diminish in any way within the program. The thing that we did want to see last quarter but which we saw this quarter was an acceleration in spend per member.

So keep in mind that the reason why we did this was to able to have the lever not just of transaction but also of ticket. That didn't materialize in Q3 but did materialize in Q4. And we are seeing acceleration in the spending per member. So we're feeling very, very good about having come out of the program transition with very minimal collateral damage in any way and a good trajectory in front of us, especially as we lean into acquiring new members.

Operator: Your next question comes from the line of Joe Buckley from Bank of America. Joe, your line is now open.

Joseph Terrence Buckley
Analyst, Bank of America Merrill Lynch

Q

Thank you. One follow up as well and then one additional question. Could you share with us – this is the follow-up – could you share with us the My Starbucks Rewards, what percent of either sales or transactions the total program represents? I mean whether people are doing it on their phone or doing it kind of in a more old-fashioned way or however they're doing it, what that total is? And then secondly, wanted to ask about the espresso bars and where you stand in that rollout and if you could talk a bit about the type of sales impact you see when you install that in an existing Starbucks.

Matthew Ryan
Executive Vice President, Global Chief Strategy Officer, Starbucks Corp.

A

Sure. Matt Ryan here. Very quickly on the percent of tender. So we see 33% of tender coming in from Starbucks Rewards across mobile and registered Cards. We see an additional 5% coming in from non-registered Cards. So between Card and the Starbucks Rewards program is at 38%. And mobile of course is at 25% right now.

Howard S. Schultz
Chairman & Chief Executive Officer, Starbucks Corp.

A

Joe, with regard to the espresso – sorry – with regard to the espresso bars...

Joseph Terrence Buckley
Analyst, Bank of America Merrill Lynch

Q

No, no. Thank you.

Howard S. Schultz
Chairman & Chief Executive Officer, Starbucks Corp.

A

What's very interesting about the evolution of the espresso bars is that we actually started this, believe it or not, in China. That the China experience and the design of the stores gave rise to the understanding that we had an opportunity in existing Starbucks stores and some new stores to offer the customer an alternative based on what was going on and what we were initially learning in the Roastery. So it's very early on domestically and we've been doing this in Asia for a while.

But if we look at what's happened in the Roastery and we say to ourselves, could we transfer the opportunity of premiumization in an existing or new Starbucks store? What we're learning is in the stores that have opened in

New York – and I'll mention them again – 85th and Madison, 10 Waverly, Brookfield Place, and 9th and Broadway, a new store in Lake Forest, Illinois – what we're seeing, and it's early days, is that customers are moving their core beverages to the espresso bar. They're enjoying the opportunity to sit at the bar because of the theater and the romance of watching their beverage be made. And the ticket is going up. But it's early.

So this is an opportunity that we have to integrate those Reserve bars in many of the stores that are going to be naturally on a remodel cycle as well as open new stores from scratch. And then as I said earlier, the Reserve stores coupled with their Roastery is going to create an opportunity for the brand to be elevated with a lot of awareness and a lot of trial. So this is part of a comprehensive all-in strategy that, we believe, will create an incremental opportunity for profit and revenue as a result of this new brand and, as a result of that, shine a halo on the core brand of Starbucks. John, you want to add something?

John Winchester Culver
Group President-China/Asia Pacific, Channel Development and Emerging Brands, Starbucks Corp.

A

Yeah, I just want to add one thing, Joe. This is John Culver. What we saw in China and what we're seeing in the U.S. is really the enablement of the partner and customer connection, really come to life in a very special and unique way. And it really played out for us very clearly in China by the fact that a lot of the Chinese consumers didn't have a lot of education around coffee, and didn't have a lot of education around brewing methods, espresso-based beverages. And it's interesting to see in China how the customers gather around the bar, basically pull out their cell phones, take pictures, take videos and really we are educating customers one at a time in China around great tasting coffee and a great experience that Starbucks is able to provide.

You walk into New York City, we were there a couple weeks ago with Howard, and we saw firsthand a similar type of experience from the standpoint of the number of people sitting at the bar, wanting to interact with the baristas and really wanting to understand the various brewing methods. And it's really something that really elevates the experience, and the customer response has been incredible, number one. And even the partner engagement around this has been remarkable as well. So we're very positive and optimistic about what the future has for this for us.

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

Karen Holthouse
Analyst, Goldman Sachs & Co.

Q

Hi. Thanks for taking the question. China/Asia Pacific comps came in a little bit lighter than I think what most folks were modeling. And in the past there's been I think a degree of seasonality to the China business related to changes in gifting practices. So just curious if you could help us understand sequentially how much of that trend was driven by China and within that maybe some seasonality to the comp? And what sort of gives you confidence that can reaccelerate? Thanks.

John Winchester Culver
Group President-China/Asia Pacific, Channel Development and Emerging Brands, Starbucks Corp.

A

Okay. Karen, this is John. Just real quick on China. Again, very optimistic about where we sit in the marketplace. We delivered a 6% comp in the market, far above any of our peer set in that environment over there. What we are seeing across China is just very strong acceptance for the Starbucks brand. You look at the number of customers that we're attracting into our stores. Our brand has never been stronger. And the customer engagement has never been stronger as well. So we're increasing frequency of existing customers, and we continue to attract new customers.

What you saw in Q4 was very similar to what we saw last Q4. Last Q4, last year we delivered a 6%. This quarter we delivered a 6% as well. There is some seasonality going from Q3 to Q4. We've seen that historically play out in China. I don't think you need to read anything into it other than the fact that our business there remains strong. We had record openings in terms of stores in the quarter in China, opening over 200 stores in the market. Our new store performance is the strongest it's ever been. Our average unit volumes, our return on investment, and our overall store level profitability remains best-in-class within the company. So very optimistic again about China and the opportunity that we have there to continue to grow. And the investments we're making on our people and the infrastructure are critical to the success going forward.

Operator: Your next question comes from the line of Jeffrey Bernstein from Barclays. Jeffrey, your line is now open.

Jeffrey Bernstein
Analyst, Barclays Capital, Inc.

Q

Great. Thank you very much. I just had a question broadly on the U.S. comps. I know last quarter there was talk about the re-acceleration in trend to a 5% plus. I'm wondering if you were to look at that, maybe qualitatively, how much do you think was the elevated macro headwinds versus maybe any kind of internal headwinds that made it more challenging to hit that. And with that as a backdrop, and we've talked a lot about the broader macro challenges we're facing and starting the year kind of at the lower end of that range, so just wondering whether the mid-single-digit or better is still the best assumption to make once you get to a system your size? Or whether or not maybe we should just be tempering the expectation a little bit so it becomes less about the quarter-to-quarter of achieving a certain 5% or whatnot? I'm just wondering how you think about that holistically there. Or maybe just define what that mid-single-digit range actually means in terms of numbers?

Scott Harlan Maw
Executive Vice President and Chief Financial Officer, Starbucks Corp.

A

That's the easiest part. Mid-single-digits is 4% to 6%. I think what I would say, Jeffrey, as we started the quarter, we guided really on Americas to get to a 5% comp, and we got there. Obviously, as you know, and it's the nature of your question, the U.S. business is the biggest piece of that. What I would say is, with the Americas at 5% and the U.S. at 6% and minus 1%, it gives you an indication of exactly how close we were to 5% in the U.S. I don't want to split hairs. I'd much rather have a 5%. But clearly comps accelerated both in the U.S. and Americas from the third quarter and I think we feel pretty good about that, given the environment.

Kevin talked a little bit about what drove some of that acceleration. We had a really good summer around innovation including limited time offers, Teavana Iced Tea, we had a pretty good quarter in food and Frappuccino recovered a bit and helped us as well. So while we didn't quite get to 5% in the U.S., it was pretty close. And I think as we look forward, I think mid-single-digit comps, if you look at the U.S. comp in the first quarter, it's 9% and the global comp is 8%. And so I think it's just prudent for us to say there's a range in mid-single-digit comps for a reason. And I think in the first half with those types of compares and the backdrop we have, I think we're just thinking we're going to be at the lower-end of that range. And, of course, as always if we can beat it, we will.

Howard S. Schultz
Chairman & Chief Executive Officer, Starbucks Corp.

A

Can I add one thing? Without putting anyone on the defensive and recognizing this is like the third rail, I would just ask you to consider that for a company our size and the track record that we have had domestically and now internationally, and as Kevin said in his remarks, the fact that our business went up on our scale during this quarter in every day-part. And if you look at our history of trying to do everything we can to really add shareholder value in everything we do, to just try and just take a step back every now and then and recognize that comp store sales, although we all recognize its importance, is not the driving force of a company that did $20 billion in revenue and $4 billion in operating profit and is adding a store a day in China and is on its way to building one of the most recognized and admired brands in the world. And yet, we're so focused on something that, yes, it is important and it is strategic, but it is not everything.

So just maybe every now and then recognize that we will have comps that will over-achieve and we'll have some comps that probably will disappoint. But we are here for the long game. This is a 24th year of our public life. The company had a market cap of $250 million at that point. It's at almost $80 billion today. And it's just the beginning. So maybe every now and then just recognize we're all in this together and comps is not the end all of everything.

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

Matthew DiFrisco
Analyst, Guggenheim Securities LLC

Q

Thank you. And I appreciate that commentary you gave on the comps. Actually, my question is with respect to that a little bit and the 2,100 stores, I would think a couple years ago you did point out that you mentioned three years ago about the changing dynamic and you spoke also about the changing in traffic for the consumer out there. I guess the 2,100 stores does sound like a very good number, a very strong number on a global basis. I wonder can you talk about that as far as what are the different type of – you talked about highest volumes in some of these markets as well. What is the biggest driver behind that? Is it the new products you're doing now? Is it the mobile app? Can you give us some color on what do you think is behind? Is it better real estate sites? Have you changed the way you select these sites on a global basis?

Scott Harlan Maw
Executive Vice President and Chief Financial Officer, Starbucks Corp.

A

Yeah, thanks for the question, Matt. I'll give it a shot. I think if you go back five years ago or so into the mid-2000s when we were opening our highest number of stores, most of those stores were company-owned stores in the U.S. I want to say it was something like 80%. And now you look at where we're opening our stores today with 60% of those stores coming in markets outside of the U.S., two-thirds of those stores are licensed stores. And even end markets like China and the U.S. where we're opening significant numbers of company-owned stores, we're using different formats as we go into markets. And so, drive-thrus remain well over 50% of our stores.

So we're going into different real estate than we were back then. We have smaller footprint stores. We have the larger footprint stores including Reserve bars that Howard talked about. So the toolset that we're using as we build stores out, both from a product offering standpoint with Reserve and flexibility for our customers with drive-thrus in international markets really helps us gain confidence with our store growth.

Howard S. Schultz
Chairman & Chief Executive Officer, Starbucks Corp.

A

I would add one other thing. And as Kevin said in his remarks, the fact that on our base for the new store performance this year, both in the U.S. and China, the best performing class of new stores in our history. And then the other thing I'd say is we're opening stores now in places that 10 years ago, even five years ago, I don't think we would have considered. And we were in Inglewood outside of Chicago last week. We've opened in Jamaica, Queens and, of course, we're so proud of the fact that we've opened in Ferguson, Missouri. In all these cases, the stores are performing at or above plan as we recognize more than ever that there's a lot of white space and opportunities to extend the reach of Starbucks. So I don't know, Kevin, if you want to add anything?

Kevin R. Johnson
President, Chief Operating Officer & Director, Starbucks Corp.

A

Yeah, I think the strength of the brand and the fact there's latent demand in these markets for Starbucks. And so, we're very thoughtful about where we locate these stores. And the teams have put together a number of tools and things to ensure we're being thoughtful about where we locate stores but when we locate them, there's demand for those stores that shows up very quickly. And it's not cannibalizing existing stores. And that just shows that there's more customers we can reach and if we're thoughtful about how we do it, it strengthens the brand and strengthens the connection with the customer.

John Winchester Culver
Group President-China/Asia Pacific, Channel Development and Emerging Brands, Starbucks Corp.

A

Yeah, and I would just add that going back to what we learned during the transformation in 2007 and 2008, we've put in all new processes and all new ways in which we're evaluating real estate, evaluating new stores, monitoring the progress and making sure that they are in fact meeting the customer demand that's out there, the latent demand that Kevin spoke about. In addition, I would also say that the level of innovation from a product standpoint that we're bringing into our stores has never been stronger.

And so you look at Cold Brew, you look at Nitro, you look at Teavana, you look at some of the food gains that we've had. We continue to innovate and then add in the digital footprint and being relevant to our customers from a digital standpoint. We are engaging our customers more now than we ever have, and the stores or that place where they come for their favorite Starbucks beverage each and every day.

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

Nicole Miller Regan
Analyst, Piper Jaffray & Co.

Q

Thank you. Good afternoon. I want to understand a little bit more about the CPG trends with – and, again, an amazing operating margin there. Can you talk about the organic top-line growth from existing and new relationships and what kind of leverage that provides to operating margin? And then when you think about the grocery store price inflation or deflation, how does that impact operating margin and is the volume growth still outpacing revenue growth? Thank you.

Michael Conway
President, Starbucks Global Channel Development, Starbucks Corp.

A

Hi, there. This is Mike Conway. I'll take that question. So from a top-line perspective, we're feeling good about the top-line performance that we've had certainly this quarter. If you look at our growth as measured by IRI both for our key businesses, Roast and Ground and K-Cup, we're up 8%. We're actually growing at a pace double that in the category. And that's really behind, number one, our strong brand. Number two, the great execution that we have on our holiday programs or LTL like Fall Blend and our innovation, and innovation that we have to come. So we feel very good about the kind of growth and share that we've been able to drive.

And what I would say is that volume versus the price, our volume and price growth are fairly close which means that we've been able to really get the right balance of promotional pricing, base pricing in the marketplace and we feel good about that. If you look at that and the margin expansion that we've been able to realize in the quarter, I think that's kind of the right balance for us, to continue to grow both the category, grow our brand and also drive share.

Kevin R. Johnson
President, Chief Operating Officer & Director, Starbucks Corp.

A

Let me just add to Mike's comments. Nicole, this is Kevin. The CPG business, in many ways, is about scale economics. And so certainly the more we're gaining share in the grocery and mass merchants that we sell to, the more efficient we are at delivering that product. So that's helping. Number two, I'll remind you that we renegotiated our agreement with Keurig and so we've got favorable K-Cup tolling fees which are also helping. So there's a variety of things that are contributing to that but I think the strength of the brand and the share gains that we continue to get for at-home coffee, Roast and Ground as well as K-Cup and establishing Starbucks as the number one share player in premium Roast and Ground and K-Cups is a big part of that.

Operator: And your last question comes from the line of Matt McGinley from Evercore ISI. Matt, your line is now open.

Matthew Robert McGinley
Analyst, Evercore ISI

Q

Thank you. My question's on the free cash generation this year in...

Howard S. Schultz
Chairman & Chief Executive Officer, Starbucks Corp.

A

We can't hear you.

Matthew Robert McGinley
Analyst, Evercore ISI

Q

Can you hear me now?

Howard S. Schultz
Chairman & Chief Executive Officer, Starbucks Corp.

A

Can you speak up a little louder?

Matthew Robert McGinley
Analyst, Evercore ISI

Q

Sure. Can you hear me?

Howard S. Schultz
Chairman & Chief Executive Officer, Starbucks Corp.

A

Yes.

Matthew Robert McGinley
Analyst, Evercore ISI

Q

Sorry about that. So my question is on the free cash generation over 2016 and the cash balance you had at the year end. You had a very good step-up in that ability to generate cash in 2016. It was about $1 billion higher versus last year. So my question is how much of that step-up in the cash generation was driven by durable increases in cash conversion relative to more one-time things, like a 53rd week, or favorable year-end timing on working capital or things like that? I think the margin commentary that you gave for 2017 made it seem like that is probably durable. But I'm curious if those balances are as good as they look?

Scott Harlan Maw
Executive Vice President and Chief Financial Officer, Starbucks Corp.

A

Yeah, the vast majority of the increase in cash is due to the core operating cash flow of the business. So that's a good thing.

Matthew Robert McGinley
Analyst, Evercore ISI

Q

Anything else?

Scott Harlan Maw
Executive Vice President and Chief Financial Officer, Starbucks Corp.

A

No.

Thomas Shaw
Vice President, Investor Relations, Starbucks Corp.

All right. Thanks again, everyone, for joining us today. And we look forward to seeing many of you at our December 7 Investor Day in New York. Have a good night.

Operator: This concludes Starbucks Coffee Company's fourth quarter and fiscal year 2016 earnings conference call. You may now disconnect.