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MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon. My name is Chris, and I will be your conference operator today. At this time, I would like to welcome everyone to Starbucks Coffee Company's First Quarter Fiscal Year 2018 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]

I will now turn the call over to Tom Shaw, Vice President, Investor Relations. Mr. Shaw, you may begin your conference.

Tom Shaw
Vice President-Investor Relations, Starbucks Corp.

Good afternoon, everyone. Thanks for joining us today to discuss our first quarter results for fiscal 2018. Today's discussion will be led by Kevin Johnson, President and CEO; and Scott Maw, CFO. For Q&A, we'll be joined by Roz Brewer, Group President, Americas and Chief Operating Officer; Cliff Burrows, Group President, Siren Retail; John Culver, Group President, International and Channels; Matt Ryan, Global Chief Strategy Officer; and dialing in from Milan, Howard Schultz, Executive Chairman.

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 factors discussions in our filings with the SEC, including our last Annual Report on Form 10-K. Starbucks assumes no obligation to update any of these forward-looking statements or information.

GAAP results in fiscal 2018 includes several items related to our strategic actions, including restructuring and impairment charges, transaction and integration costs, gains related to changes in ownership of international markets, and other items. These items are excluded from our non-GAAP results. Please refer to our website at investor.starbucks.com to find the reconciliation of non-GAAP financial measures referenced on today's call with our corresponding GAAP measures. This conference call is being webcast and an archive of the webcast will be available on our website as well.

I'll now turn the call over to Kevin.

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

Well, thank you, Tom, and welcome everyone. Starbucks reported another quarter of record financial results in Q1 of fiscal 2018, highlighted by continued acceleration in our China/Asia Pacific segment.

On today's call, I will provide an overview of company-wide performance in Q1, with a particular emphasis on our two unique and powerful global growth engines; our retail businesses in the U.S. and China. I'll then turn the call over to Scott, who'll provide further detail on segment performance and an update on the impact of the new tax law.
For the quarter, Starbucks delivered record revenues of $6.1 billion, a non-GAAP operating income margin of 19.2% and a non-GAAP EPS of $0.65 per share, and we opened 700 net new stores globally with our newest class of stores continuing to deliver industry-leading returns and higher AUVs than the immediate prior class.

China, once again, our fastest growing market in Q1 with 6% comp growth, driven entirely by increased transactions and 30% revenue growth. Customer response to our Shanghai Roastery has been extraordinary, and the Roastery is already performing well above expectation. I'll share more details around Starbucks' plans to maximize our opportunity in China in a moment. But let me start the call with an update on our U.S. business in Q1.

We ended Q1 with 6% revenue growth and 2% comp growth in the U.S. Continued strength in throughput at peak and strong digital performance were noteworthy highlights in the quarter. But we've recognized that overall our U.S. operating performance fell short of expectation. We have isolated the drivers of our Q1 underperformance, and I want to take you through both the details and the corresponding actions we are taking.

Through the first half of the quarter, our U.S. comps were 3% with strong performance at peak, more than offsetting some softness in the afternoon. But as we launched our holiday program in mid-November, we saw a slowdown in transaction comps, bringing total comps for the back half of the quarter to roughly 1% with transaction comps slightly negative.

Even though we grew operating income, these developments contributed to margin compression we experienced in the U.S. compared to Q1 a year ago. The decline in transaction comp was primarily driven by two factors. First, while traditionally contributing to Q1 comp growth, our limited time holiday beverages, holiday gift cards and holiday merchandise available for purchase in our stores' lobby, underperformed in Q1. Holiday LTOs and merchandise did not resonate with our customers as planned.

Let me be more specific. In Q1, our food comp was 2%. Our core beverage comp, excluding holiday limited time offerings, was 1%. And together, our holiday LTO and lobby items had a negative impact of over 1 point of comp. We are aggressively rationalizing our merchandise approach in conjunction with the transformation of our lobby strategy going forward.

Second, the challenge we have discussed with you over the past several quarters involving softness in business by occasional, non-Starbucks Rewards customers, a challenge likely exacerbated by the traditional changes in our customer routines and traffic patterns during holiday, continued with our afternoon and evening dayparts, typically catering to less frequent customers and second visits from more frequent customers, coming under increased pressure as the quarter progressed.

Another proof point of changes in holiday routine was negative mall store comp performance, several points below non-mall locations as we moved through the quarter. As a reminder, mall stores comprise only 6% of our U.S. company operated locations. We have a clear understanding of the issue and are accountable to fix it, just as we did with throughput at peak. The strength of our core customers, the performance of our business through the morning and lunch daypart and upcoming food, beverage and digital innovation gives us confidence that we will be successful in doing so.

Let me now share our plans for bringing the business to targeted levels of revenue growth, operating performance and profitability through the lens of the six operational priorities we set out for you last year. These priorities remain the drivers of our growth and they will enable a turning of our U.S. business. Our commitment to these priorities is unwavering.
Let me start with our efforts to accelerate U.S. comps across all dayparts. We continue to reap the benefits of the success of our efforts to increase throughput at peak. Specifically, our highest peak volume stores continue to out-comp the average for our U.S. portfolio overall, with efforts around staffing, technology, and lean principles; all yielding measurable results.

We've now seen three successive quarters of sustained positive comp growth at peak, and believe that plan enhancements will continue this trend, and are encouraged by our ability to have so quickly rallied our store partners, equipped them with the tools, technology and resources to successfully improve operations. We will apply the same disciplined approach to improve performance in the afternoon daypart, and have identified a number of key operational actions that are underway.

We are focused on elevating the Starbucks experience in the afternoon daypart, as store partners sharpen operational focus and tune staffing and scheduling, simplification processes and leverage improved routines and lean techniques. We are also driving continued innovation in food and leverage.

Our Mercato fresh food menu is continuing to perform well in Seattle and Chicago, the two markets we launched last year, and we are planning to deploy Mercato in at least six new markets in fiscal 2018. We recently launched Blonde Espresso roast. This is the first time we've offered a second espresso roast in our stores. We believe this roast is appealing to a broad audience seeking a lighter, sweeter, espresso experience.

We have a big opportunity to leverage our core beverage platforms, particularly in iced coffee, tea, cold brew and draft beverages, all of which skew toward the afternoon. In response to strong customer demand, we are accelerating the rollout of Nitro Cold Brew from 1,300 stores currently to 2,300 stores in the U.S. by the end of the year. We've seen approximately one point of additional comp growth in stores offering Nitro Cold Brew during 2017. Nitro also provides the foundation for a broader platform of draft beverages that expand beyond coffee to include alternative milks and tea-based nitro-infused beverages.

Our plant-based beverage platform continues to expand, leveraging almond, coconut, and soy milk alternatives. Our refreshment platform including tea and Starbucks Refreshers contributed comp growth again this quarter. These beverage platforms also align with our focus on the afternoon occasion. In addition to food and beverage innovation, we continue to accelerate the power and momentum of our digital flywheel, an initiative that has taken on added significance, as we look to materially expand our universe of digitally-connected Starbucks customers beyond only rewards members.

Let me touch on five developments that underscore the progress we made against this priority in Q1. We added over 1.4 million active Starbucks Rewards members in the U.S., up 11% year-over-year, and now have 14.2 million active members. Mobile payment in the U.S. has grown to over 30% of total tender. The ubiquity of mobile and credit card payment is enabling us to begin an exploration of cashless stores in the U.S. We expect payment methods will continue to evolve with acceptance increasingly becoming the global currency of the future.

Building on partnerships with companies like Chase, Tencent, Alibaba and others, enables us to explore new ideas that leverage our digital assets, global retail footprint, and global customer base with the digital payment platforms of today, while also monitoring the landscape of potential payment platforms of the future. Through our rewards program, we continue to drive increases in per-member spend by leveraging personalized offerings and suggested selling to our customers.
By expanding capacity at peak, we have now the ability to offer Mobile Order and Pay to our non-rewards customers, and will begin accelerating the ramp up of Mobile Order and Pay to all customers beginning in March. We are accelerating our marketing engagement to expand digital customer relationships this quarter. Here are some examples of actions underway. In partnership with Chase and Visa, we are launching a co-branded credit card in February. These customers will earn stars at an accelerated rate at Starbucks as well as earn stars everywhere else they shop.

In April, also with Chase and Visa, we are launching a co-branded stored-value card targeted to customers who don't want or can't qualify for credit cards. This card will also let customers earn stars wherever Visa is accepted. In March, we are launching a significant marketing initiative to sign up customers for special offers outside of Starbucks Rewards. With only 14 million of the 75 million or so unique customers who visit us each month signed up for rewards, we have a tremendous opportunity to leverage our new digital technologies to initiate and advance additional direct digital relationships.

By the end of the fiscal year, we expect to establish millions of incremental digital customer relationships outside of Starbucks Rewards, giving us an entirely new direct marketing capability to a vast customer audience. We will update you on progress of our digital expansion initiatives as we move through the year. Today, our U.S. business is a key driver of Starbucks' overall financial performance. And while we face challenges in Q1 with holiday merchandise and LTOs, we are making progress against clear and consistent priorities, with total customer transactions across new and existing stores up 5% year-on-year.

Last year, we successfully dealt with our morning daypart and peak throughput issues and we are applying the same rigor to addressing the occasional customer in the afternoon daypart issues. We look forward to updating you on our progress, as we tune our U.S. retail growth engine to continue delivering industry-leading growth, profitability, and return on investments long into the future. Enabling long-term growth in China is a key priority, as it now represents our second largest and consistently our fastest growing market.

Starbucks has been operating outside of North America since the opening of our first store in Japan in 1996. Today, we operate half of our stores, nearly 14,000, in 75 markets outside the U.S. The growing relevance and success of our international business and specifically our business in China, has emerged as a growth driver that is rapidly moving us beyond our longstanding dependence on our U.S. business for needle-moving growth.

Today, we have two powerful, independent, but complementary engines driving Starbucks' global growth with a long-term opportunity clearly visible in China. Starbucks has cracked the code on China, and no western consumer brand is better positioned than Starbucks in China. You have to experience our business in China for yourself to fully appreciate it, but we are much more than simply a coffee retailer as our world-leading financial and operating performance attests.

Let me share a few metrics that underscore the size of Starbucks China opportunity. In 2014, China's GDP totaled $11 trillion, and many economists expect it to exceed $15 trillion by 2021. Rapid GDP growth is fueling a massive increase in China's middle class, expected to reach 600 million consumers by 2021, up 100% from three years ago and almost twice the size of the total U.S. population.

From an investment thesis, we have best-in-class unit economics, decades of white space to grow in both physical and digital retail, the most trusted brick-and-mortar brand in the market and a world-class management team. And we are in the nascent stages of building a business that will continue to deliver an increased portion of our revenue and operating income growth. The deep respect we have for our customers and partners in China and that our customers and partners in China have for the Starbucks brand and each other, have resulted in
rapid, sustained customer and market growth. And the strong underlying revenue and profit trends of the past will drive the many decades of growth on the horizon.

Leveraging our digital flywheel continues to represent a huge opportunity and unlock for us in China. Since launching WeChat Pay one year ago and adding Alipay in September, digital payments have increased to over 60% of total tender. 90-day active Starbucks Rewards members now total over 6 million, and our e-commerce and social gifting in China represented nearly 20 million in Q1, up threefold from a year ago. These are the reasons we felt comfortable doubling down on China through the East China acquisition, the transaction we closed in December. East China is now being integrated into our company-operated business, enabling us to benefit and to further leverage Belinda Wong's world-class China management team as well as the scale economics that come with it.

As we complete the integration of East China, we will look to further accelerate our new store growth in China. I have no doubt that one day Starbucks will have more stores in China than we have in the U.S. And it's the reason we selected Shanghai for Starbucks first international roastery, highlighting our fifth operating priority, elevating the Starbucks experience through roasteries and reserve. Starbucks Shanghai Roastery opened only last month, providing further evidence of our future opportunity in China and is among the crowning achievements in the company's history.

Customers, in some cases, are lined up for hours to enter the roastery and be taken on an immersive, multisensory coffee, food and tea journey. On its very first day of operation, the Shanghai Roastery became the highest grossing Starbucks store in the world, averaging more than double the number of transactions of our highly-successful Seattle Roastery, and with an average ticket of $29. The unparalleled retail experience delivered by the Shanghai Roastery will enable us to serve well over 1 million customers every year. At the same time, amplifies and elevates the Starbucks brand across China and CAP overall.

Noteworthy is that our Starbucks Roastery in Seattle continues to delight customers and drive double digit comps. In November, we opened the Princi bakery and café in the Seattle Roastery and are already seeing significant lift to total food sales. The Princi bakery and café in the Shanghai Roastery is also driving significant customer engagement and revenue. The artisan nature and high quality of Princi baked goods are resonating loudly with our customers, and we see a major opportunity to increase sales of Princi food beyond roasteries.

We are now venturing into building standalone Princi bakeries, complete with Starbucks Reserve coffee and coffee bars. These stores will feature Reserve coffees, Princi food, and designed with the elements of the roastery design and product experience for customers in markets across the globe. Starbucks Roastery, Starbucks Reserve brand, and Princi, operations that we refer to collectively as Siren Retail, remain central to our innovation capabilities and our strategy of maintaining our leadership position as the leading premium coffee retailer.

We currently have four roasteries under construction and the potential opportunity for Princi bakeries with Reserve coffee over the next decade. The opportunity is significant as we're off to an excellent beginning to what we believe is an emerging food revenue and profit stream over time. As we pursue our Starbucks Reserve strategy, we benefit from the decades of experience that Howard brings to this business. As Tom mentioned, Howard is joining the call today from Milan, where he is working on our next international roastery and he is available to share his thoughts during Q&A.

Our Channels business is focused on our sixth operational priority of gaining share of at-home coffee. Scott will cover this in more detail, but in Q1 we grew share in the premium single-serve and packaged coffee categories to
a record level, despite an increasingly competitive environment. We have built a powerful CPG business in the U.S., and are committed to leveraging that business to create additional shareholder value going forward.

While we invest in the priorities I've outlined, we also continue to make progress against our efforts to streamline the company. Besides completing East China acquisition, in Q1 we also closed on the sale of Tazo to Unilever, transitioned Taiwan to a license market, and continue to close Teavana retail stores in Canada and the U.S. We plan to have all U.S. and Canada Teavana stores closed by the end of this month. Going forward, you may expect us to take additional actions to further streamline the company and unlock value.

A few final points. While we recognize that our revenue comp and EPS performance in Q1 fell short of both our current quarter and long-term guidance, I want to make clear that our commitment to our long-term growth targets and strategy, including our commitment to returning $15 billion to shareholders over the next three years in the form of dividends and buyback, is unwavering. We have sightline on the areas that need to be addressed in our U.S. business, and Roz Brewer and her team are aggressively pursuing the improvement plans I shared with you today. And I assure you that we are just embarking on what will ultimately prove to be the most powerful and compelling growth opportunity in Starbucks' history, China.

With that, I'll turn the call over to Scott. Scott?
We entered seven new cities and opened a Q1 record 188 stores in China, and now own and operate over 3,100 stores in 138 cities. Our newest class of stores in China continues to outperform even the immediately prior class and deliver record revenues and profits and our best returns anywhere in the world. CAP’s non-GAAP operating margin increased by 210 basis points, driven primarily by strong performance in China and South Korea. CAP’s non-GAAP operating income increased nearly 20% to $212 million, once again representing the majority of Starbucks operating income growth in the quarter.

Regarding Japan, while overall profitability, new store performance and total revenue remain in line with our expectations upon acquiring 100% of the market, our comp store performance continues to be impacted by softness in limited-time offerings, Frappuccino LTOs in particular. We remain committed to turning Japan back to positive comp growth, as we work through the mix shift issues. The new Japan Starbucks Rewards program launched only last quarter continues to resonate with our customers. We’ve already added over 600,000 new rewards members, up 45% in a few short months.

Turning to EMEA. EMEA delivered revenue growth of 8% to $284 million, or up 3% after adjusting for 5 points of foreign exchange. Company-operated store comp declined 1% driven by soft comps in the UK. Noteworthy is that today less than 20% of our EMEA total store portfolio is company-owned. Thus a better measure of the performance of the EMEA segment is system-wide comps, which grew 3% in Q1, despite the difficult consumer, economic and geopolitical backdrop.

Operating margin of 13.8% declined 300 basis points over last year. Margin expansion in our licensed business was strong and in line with expectations, driven by successful new store openings and strong system comps. But this was more than offset by underperformance in our company-owned markets. We remain committed to both growing Starbucks' profitable and successful licensed business and lowering our EMEA overhead structure.

On to Channel Development. Channel Development revenues reached $560 million in Q1, up 1% year-over-year but up 4% after adjusting for 3 points of impact from the Tazo sale this quarter and a change in accounting treatment for certain receivables compared to 2017, on top of 8% growth and 16% growth in the first quarters of fiscal 2017 and 2016, respectively. While we achieved record market share in both premium roasting ground and K-cups in our core U.S. CPG business in Q1, revenue has been impacted by increased competition down the aisle.

Our bottled coffee business with Pepsi delivered strong overall results again in Q1. Also, we now have sold over 1.9 million bottles of Teavana bottled tea through the partnership with have with Anheuser-Busch launched last year. And we still expect to launch Teavana packaged tea down the aisle before the end of 2018. And in China, we have sold 30 million bottles of Frappuccino beverages since launching our relationship with Tingyi five quarters ago. We now offer an expanding line-up of bottled coffee beverages for Chinese consumers to enjoy at home, at work, or on the go. Each of these partnerships is a successful example of the power of combining the Starbucks brand with the product, marketing and distribution capabilities of leading food and beverage companies. Channel Development’s operating margin remained strong at 43.4%, down slightly from last year, given lower sales flow-through.

Before moving on to full-year fiscal 2018 targets, I'd like to identify three events that will have a significant positive impact on our financial returns moving forward. Our ongoing efforts to streamline our operations, the projected impact of our recently-completed East China acquisition; and the impact of the new U.S. tax law. You can see specific financial impacts for each of these items in the schedules we have provided on our website. But I acknowledge the size and absolute number of these adjustments adds complexity to your analysis and modeling.
of our performance. Recognizing this, our goal is to provide you with the insight and transparency you need to fully appreciate the meaningful lift in profitability we expect to see from each of these three areas over time.

During the quarter, we accelerated and advanced our efforts to streamline our business that we began discussing with you last year. As a reminder, streamline is a company-wide lens through which we are examining each of our businesses in order to focus our investments on those businesses that will meaningfully contribute to revenue and profit growth, while licensing or exiting those that won’t.

During Q1, we recognized large gains on the sale of Tazo, the acquisition of East China, and the sale of Taiwan while recording certain charges for exiting all Teavana stores, among other actions. One specific example relates to product simplification. We are removing over 200 SKUs from our U.S. retail stores, primarily merchandise in the front lobbies of our stores, representing over 30% of total lobby items. This simplification effort increases our focus and reduces operational complexity in our stores. And we anticipate eliminating these SKUs will lower comps by half a point over the course of 2018 but have a nominal impact on profit, given the lower margin and higher write offs associated with these products. Obviously, merchandise performance this holiday underscores the importance of this effort, but it is important to note that comps in our lobbies have been flat to slightly negative for several years. Also, our full-year guidance set out for 2018 included the estimated impact of these streamlining activities including the U.S. comp impact of SKU rationalization.

Finally, we are well on our way to returning the $15 billion of capital to shareholders Kevin referenced earlier, with $2 billion returned via dividends and share repurchases this quarter, a new record for Starbucks.

On December 31, 2017, Starbucks paid $1.4 billion and assumed full ownership of over 1,400 stores previously operated by our formerly 50% owned East China JV, doubling down on China, our highest returning and fastest growing market. The East China business will fully be consolidated and reflected in our financial statements beginning with Q2.

We expect the transaction to be neutral to slightly accretive to earnings in 2018 with a more positive impact in 2019, excluding the following estimated items; the gain on acquisition, amortization expense of acquired intangible assets, and transaction and integration expenses. These items will be removed for non-GAAP reporting and adjusted as we move through 2018. The financial impact of consolidating East China includes a 4 percentage point lift to consolidated revenue and a slightly negative impact to consolidated operating margin.

As you may recall from the acquisition of our business in Japan, the margin change is driven solely by the change in ownership whereby we now have 100% of the revenue, expense and profit, as opposed to a small portion of the revenue and roughly half the profit under the former ownership model. The change is expected to drive CAP segment margin moderately lower in 2018 with strong growth returning once we fully lap the acquisition in 2019. We plan to discuss these impacts in greater detail during our China modeling call on January 31. Again, the impact of East China was included when we introduced our fiscal year 2018 guidance last quarter.

Let’s move on to the change in U.S. tax law. Like most U.S. companies with international operations, we are still evaluating the impact of the U.S. tax law change on our income statement, balance sheet, and capital distributions to shareholders. Future interpretation of significant aspects of the law by constituencies in Washington D.C. and related accounting guidance could have some impact on our ultimate effective tax rate for 2018, 2019 and beyond. With that said, let me share with you our current estimates.

We expect our 2018 GAAP tax rate will be 23%, with significant impacts from the gain on East China acquisition and transition-related items from the U.S. tax law change. The East China gain will impact our 2018 effective rate
by 5 points. Partially offsetting this is approximately 2 points, or an estimated tax charge related to deemed repatriation of international earnings partially offset by an estimated tax benefit from revaluing our net deferred liability position at lower statutory rates.

Excluding the net 3 points of favorability from these drivers, our non-GAAP effective tax rate is estimated to be 26% for 2018 and beyond, or roughly 7 points below previous guidance. This delta provides roughly $350 million of additional net earnings before reinvestment for 2018. The majority of the savings will go to the bottom line with more than 50%, but less than 60%, accruing to earnings. The vast majority of the 40% plus remaining will be invested in our U.S. partners via wages and benefits above our plans with the balance funding accelerated digital investment. Specifically, we anticipate increasing partner and digital investments by $180 million to $220 million on a run rate basis in 2018 with a little less than half of this impacting 2018 profits given the timing of investments during this fiscal year.

Also, we announced this week a one-time stock grant to our U.S. partners that we estimate will total $120 million and will impact 2018 and 2019 ratably. The vast majority of this grant will go to our U.S. field partners and we will exclude this stock grant related charge from our non-GAAP results. We expect a modest amount of incremental cash flows from the tax law change net of reinvestment. I want to reiterate that these allocations and estimates will likely change over the course of 2018, but they are reasonable approximations for now.

Let's move on to 2018 targets. We are updating the financial and operating targets we have previously provided for fiscal 2018 for the expected impacts of the U.S. tax law change and business performance in Q1. We still expect consolidated revenue growth in the high single digits excluding approximately 4 points of favorability from the East China acquisition, and a roughly 2 point reduction from other streamline activities. We also still expect comps to grow 3% to 5% for the year, consistent with our long-term guidance. Given the challenges in Q1 and expectations for a somewhat softer Q2, we expect to be near the low end of comp guidance range for the year.

Given the margin contraction in the first quarter and likely pressure on Q2, we now anticipate a slight operating margin decrease for both total company and the Americas for the full-year before the additional partner and digital investments. Including these investments, we expect total company and Americas operating margins to decline moderately versus 2017. The operational priorities focused on the U.S. business that Kevin discussed and the middle of the P&L savings targeted for the balance of the year are expected to contribute to improvement in the second half of the year. Roz and the team are laser-focused on ensuring we can deliver targeted savings for the year in cost of goods sold, waste, labor, and beyond. These savings started in Q1, but ramp as we move through the year, and we have specific action plans to ensure we obtain the savings we need by area.

Excluding the ownership change impact from our purchase of East China, we still expect CAP operating margin to be moderately higher in fiscal 2018 relative to the prior year. Given first quarter performance, we now expect moderate expansion of EMEA operating margin in 2018, and channel development is still expected to deliver slightly improved operating margin for 2018.

Given all these inputs, we expect fiscal 2018 GAAP EPS in the range of $3.32 to $3.36, and non-GAAP EPS in the range of $2.48 to $2.53. This is consistent with non-GAAP EPS of $2.30 to $2.33 provided on last quarter's earnings call with the impact of a lower federal statutory rate from the U.S. tax law change net of reinvestment as the only difference. All other guidance is unchanged from last quarter.

To summarize and be clear, adjusted for the impact of tax law changes, we remain within our full-year 2018 guidance range given last quarter related to the key items of EPS, comps, and revenue growth, but below that guidance on global margin.
To achieve these targets, we will remain disciplined with our investments and laser-focused on delivering an elevated experience to our customers, while at the same time improving our comp revenue and profit in the back half of 2018. This discipline will be key to delivering our top line and bottom line goals.

As Kevin stated, we have a clear set of actions underway to improve comp growth and profitability as we move through the year. As always, credit for our success in Q1 belongs to Starbucks partners around the world who proudly wear the green apron and work to deliver an elevated Starbucks Experience to our customers through nearly 100 million individual occasions every week, but who do so with heart and passion one cup at a time.

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

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**QUESTION AND ANSWER SECTION**

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

_Sara Harkavy Senatore_
_Analyst, Sanford C. Bernstein & Co. LLC_

**Q**

Thank you. I was hoping to sort of just talk a little bit about the first quarter and the implied rest of the year, which is to say you suggested that holiday and merchandising was an issue, but then also noted that 2Q will be softer, which means that maybe it wasn't just holiday if January was also off to a soft start. So I guess, first, are you confident that you have the right diagnosis? Is there any chance that you are either losing share or cannibalizing yourself? And then second, to what extent can you preserve some of the earnings or the margin, if in fact, the low end of your guidance doesn't materialize through better expectations in the back half, which is sort of what happened in 2017?

**Scott Maw**
_Executive Vice President & Chief Financial Officer, Starbucks Corp._

**A**

Yeah. Thanks Sara. It's Scott. I'll start. I think what's important to understand in what we're saying about Q2 is given some of the things that happened specifically during holiday, we're seeing some impacts of that early in the second quarter. And specifically what we're seeing is we sell a lot of gift cards in the lobbies of our stores and through third parties. And those gift cards, once again this year, went to about one in six Americans, and the gift card loads were about flat year-over-year. But as you know, over the last many years, those gift cards have actually contributed meaningfully to comp, both as we closed out the first quarter and then importantly in January and February and a little bit beyond as we went through the second quarter. And because those gift cards were roughly flat – still sold a lot of them – we're just a little bit cautious on how the quarter's starting. So that's the first thing.

The second thing is in the lobby category, what we see coming through into January is a little bit additional softness above what we'd expected. So Kevin talked about holiday LTOs and lobby down over a point. Lobby remains soft in January, so those two things are just a little bit of headwind. And so, I think what we signaled for the year is we still have a high level of confidence in being within our 3% to 5% range. We're just a little bit cautious for Q2. And really, EPS and revenue growth and comp growth still holds with what we guided last quarter.
And Sara, this is Kevin. Let me take your second question about share or cannibalization. I mean, the short answer is no. And let me share the data with you that leads us to that conclusion. Certainly, we look at many external data sources to inform us of macro trends in away from home coffee, and certainly away from home food and beverage. Those trends would suggest that overall daily customer occasions in food and beverage are relatively flat. Now, when we triangulate those data points with the fact that we grew total customer occasions across existing stores and new stores by 5% this quarter, that would imply that we are growing transactions faster than the market and taking some share.

Now, the better view that we have is when we look at the microtrading areas. Now, this is where we have our own analytics, where we look at the microtrading area that provides us data on traffic patterns. And whenever we build a new store in that trading area, we have predictive analytics to tell us what we think will happen and then we have post analytics to tell us what actually happened. The data suggests that when we build a new store in a trading area, we see increased customer occasions for Starbucks. When a competitor builds a new store at a microtrading area, our data shows little to no impact on Starbucks' traffic in that microtrading area. Now, certainly a similar dynamic exists when a competitor runs up a product or pricing promotion or schedule in a trading area. And we look at these microtrading areas very carefully. And so that's a data-driven analysis. So when you triangulate these two data points, it's evidence that we're not losing share to competition and it's evidence that we're not cannibalizing as we build new stores. And so that's how we think about it.

Okay, thanks, and then just a question on can you preserve the P&L as the comp comes in, stays at 2%?

Yeah, I think what we've said, and we talked about this a little bit last quarter, Sara, is that in order to hit the comp guidance and the revenue guidance and the profit guidance of 3% to 5% high single digits and 12% plus, we need that 3% in order to get to 12% plus. With that said, given just a little bit of softness in the first half of the year, we still think we're going to deliver a 3% for the year and therefore deliver the full EPS and margin guidance. I think the thing I was trying to say in my prepared comments is the first half of the year is probably going to be a little bit softer, with the second half of the year accelerating given the things we're doing on streamline, the things we're doing in the middle of the P&L, and a little bit of benefit from buyback. So I think we'll get back to 3% and preserve the margin.

Yeah, I agree with that. The only thing I would add is just to be careful not to over-rotate just looking at the U.S., China is becoming a bigger and bigger part of the growth agenda and contributing a larger and larger percentage of our operating income growth. The 30% growth that we saw in China this last quarter, we just closed on East China, the Shanghai Roastery. And so I think you need to look at both these growth engines when you consider the overall enterprise P&L.
Hi, good afternoon. Just one clarification on the commentary on fiscal second quarter. Are you signaling you expect it to be weaker than what you just reported for Q1 or more of the same? And then I guess my real question is about as you diagnose the U.S. business and look at the consumer feedback metrics that you get, are you seeing anything in the consumer feedback that would suggest any issues related to brand or operational performance or anything of that nature? Thanks.

Yes, I'll start, David. Maybe I'll have Roz take the second half. So if you do the math on at least a 3% for the full-year, and we just did a 2%, I think it gives you a pretty good idea of what we think by somewhat softer. We're not signaling that January has been off to a big negative for us. That is not what we're signaling. All we're signaling is a little bit softer estimate for Q2. So you can kind of do the math and figure out. We didn't put a number on it, but I think it's pretty clear about where we think we'll land.

Roz, you want to cover the customer piece?

Yeah, so concerning the customer piece, I will say that we've been really looking carefully at this afternoon daypart and the customer that visits our stores during that timeframe. And we're learning a lot about them. But I can tell you that they're confident about our brand. They still are committed to Starbucks. We are making sure that we are ready for the customer in those afternoon dayparts by looking at our routine efforts in the store, and to make sure that we've got the right partners in front of them. So we feel good about the customer and their connection to us. And we'll continue to make sure that they stay in line with who we are as a company.

And Kevin, can I just add one thing about the equity of the brand? Can you hear me?

Yes. Yeah, please, Howard, yeah, go ahead.

Just in terms of the equity of the brand, just in recent weeks, two things came out that I think demonstrate and reaffirm the strength, the trust, and the confidence in terms of Starbucks as a brand and a trusted company. Fortune's survey came out and Starbucks was the fourth most admired company in the world. And then we have a constant effort year-in and year-out to make sure that we're as relevant as possible with young people. And what came out is that Starbucks' relevancy among teens is number one in any food and beverage retail brand in America. So, I think in terms of the equity of the brand, there's no issue whatsoever. This is a daypart challenge in the afternoon, and just like we figured out and cracked the code in the morning daypart, we will do the same thing in the afternoon.
Sharon Zackfia  
**Analyst, William Blair & Co. LLC**

Hi, good afternoon. I guess a question on the digital side. I think last quarter you provided us with what the comps were for the Starbucks Rewards spend versus the more occasional customers. I was wondering if you might provide that again. And as it relates to kind of broadening the digital ecosystem, I mean when can we kind of expect more information from you? And are there thoughts about enabling some sort of Starbucks Rewards program where you don't have to have a preloaded card?

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

Thank you for the question. Matt Ryan here, Sharon. First of all, as is obvious in the numbers, virtually all of our comp this past quarter came from our digital customers. And we saw significant growth in the number of members, up 11% or so year-on-year, as well as healthy growth in member spend. So, we're very, very pleased with what we saw. We've leaned into customer acquisition and we saw results.

During this coming quarter, you're going to see some significant new initiatives added on, which have both short-term and long-term potential benefits. We are going to be targeting not just the Starbucks Reward customers, but all customers with ways for them to sign up and engage with us directly. That will create a new pool of customers that we can use our marketing capabilities to reach and talk to and build business from. You'll see that emerge across the course of the quarter, especially in March. And you will see us begin to then have a greater pool of people from whom we can recruit future Starbucks Reward members, as well too. There are a number of different things teed-up, not just for this quarter, but across the next year that include some of what you've been alluding to, and you can expect us to continue to make digital the focus of all of our marketing efforts moving forward.

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

John Glass  
**Analyst, Morgan Stanley & Co. LLC**

Thanks very much. Two, if I could. First, just I'm still struggling with why the non-Rewards customer, the occasional customer, is not coming as often. If you say the brand is still strong and relevant, particularly young people, but they're not coming back. Is it as simple as the Frappuccino platform, for example, is getting tired, and if it is, how soon can you substitute products that really drive that afternoon business? Can you talk a little bit more about specific customer insights? I didn't think I heard that in the answer to a prior question. And on the guidance, I just wanted to make sure I understand, you've kept your guidance the same, but I think you said margins are going to be below and comps are going to be at the lower end, so – and is excluding taxes. What's the plug that still gets you there if comps are at the low end and margins are below?

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

Yeah, John, this is Kevin. I'll take your first question and I'll let Scott take the second one. When you think about our customer patterns, it's first important to note that our core customer, and especially in that morning daypart, is very strong. And that's just reflective of the increased throughput at peak that we've driven, and I would say the digital growth that we've seen. So, core customers, morning daypart, daily ritual, throughput at peak, strong. And that's beverage, food attach, strong.
Number two, what we’re calling the occasional customer, in some ways you could say are those non-Rewards customers, or non-core. Now, the fact that we’ve grown active Rewards by 11% means we’re attracting more and more of the occasional customer into Rewards. So, part of the reason you see that comp, you say oh, well, our occasional customers aren’t growing, that’s because a lot of them are joining Rewards. And the more we get them in that digital ecosystem, the better because now we can communicate directly with them; we can personalize offers that are contextually relevant to them. We can do so much more to create a great experience for those customers when we have digital combined with our brick-and-mortar experience.

So then number three, you say, okay, of those customers who haven’t joined Rewards, what’s happening with occasional customers? Now, we have a higher volume of occasional customers in the afternoon. And in many ways, you think about the morning daypart, and a lot of that is really driving the need state of convenience as customers are getting their beverages and food on their way to work or school or some activity. What we find the afternoon is a customer occasion that's more about the third place. And so, in many ways, the opportunities we have to continue to enhance the experience in the third place, drive innovation around food and beverage that resonates in the afternoon, and as Matt said, the number one thing we can do is now connect with those occasional customers in a digital way. And so, that’s what we see happening, and that’s why the plans that we have are geared exactly to that.

Roz, you want to touch upon sort of the plans that we have driving those three pillars?

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

Sure. So, first of all, let me talk about, in the first quarter, we added the 1.4 million new active members. And that really gives us an opportunity to do just what Matt mentioned is to bring them to the same level of our Starbucks Reward customers that have been enjoying our business in the morning daypart. But second, we have very strong beverage innovation plans for the remaining part of the year. And I know we’ve been talking to you about our beverage innovation for some time now, but we’ve been able to for the first time in a long time introduce a second espresso roast for the first time our Blonde introduction that just started in the month of January. We’re excited about that.

But second, we have a number of cold offerings that we’re introducing, and some of them are accelerating into the second half of the year. And I’ll just remind you, cold beverages are nearly 40% of total beverage sales, and 50% of the overall growth that we’re seeing right now is from our cold line-up. And that’s up 230 basis points for our company. So, the acceleration of things like our nitro roll-out, our Teavana teas and our premium iced beverages, this is going to help us in the second half of the year. And these are items that have not existed in our product line-up. And when you align that with our food success, it really creates a package for us. And remember our food represents right now 21% of our total revenues. So we’ve got great moves in our beverage line-up and the food attach that we’ve been seeing quarter-over-quarter will continue into the second half of the year.

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

And then John, your question on margin, I just quantify it a little bit for you. We had slight margin expansion in our last guidance, and now we’re seeing a little bit of margin contractions. We’re not talking about big dollars, but you’re asking a fair question. There’s two things. First of all, we did get a little bit more favorability than we had forecast below the line this quarter for some of the gift card unredeemed true-ups that I talked about. And then all of the net of the streamline activities are coming in a little bit more favorable than we had originally thought. Again, both of those are relatively small amounts, but don’t have a big impact obviously on operating margins but allow us to hold our EPS guidance.
David Palmer
Analyst, RBC Capital Markets LLC

Thanks. Yeah, I heard in some previous answers you highlighted the digital initiatives and you mentioned cold beverage innovation just then. Are those the major factors that give you confidence in a back half acceleration? It sounds like it could be significant in your thinking, or at least you’re banking on that. Perhaps you can give some sort of a ranking of what is giving you confidence in the back half acceleration. Thanks.

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

Yeah, and maybe, David, maybe I’ll start financially and I’ll ask Matt and Roz to weigh in operationally, because obviously what we’re mainly focused in talking about is the U.S. business. So if you talk about the global business back half acceleration from a margin standpoint, it’s the things that we’re doing in the middle of the P&L around cost of goods sold, around waste, and around labor. We talked about those. That’s the first thing.

The second thing is acceleration of profitability as we bring East China into the fold, fully wind down Teavana, we’re a little bit more optimistic on how that’s going to add to overall profitability. And then just to be specific, we expect the first half of the year in Americas’ comps to be a little below the average for the year and the second half to be a little bit above. So I’m not signaling a big acceleration in U.S. comps in our forecasting. We see that as potential opportunity depending on how things land, but that’s now what we’re saying in that comp guidance we’re giving, just to be clear. But maybe I’ll turn it over to Matt to talk a little bit about the digital opportunities first, and then Roz can cover ops beyond that.

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

Absolutely. So one of the things we see is we see continued growth in the core Starbucks Rewards program. We’ve seen healthy growth in recent quarters, and we have every indication that the investments we’re making in technology that are sort of behind the scenes and less visible to you will continue to drive both acquisition as well as per member spend. So we’re very confident in that. I think the more important news is we’re adding on a couple of more major initiatives. So this quarter, we will be launching with Chase and Visa, our first ever co-branded credit card, and that will enhance the value of the program to many of our customers.

The thing that I would like to highlight as well is that we are also doing more to reach our non-Starbucks Rewards customer digitally and establish digital relationships. This includes making Mobile Order & Pay available at scale to all customers starting in March, as well as deliver initiatives, which you will see as the quarter unfolds in which we actively sign up new customers with special benefits and offers that will be meaningful and make a difference in our ability to market and personalize beyond just the core Starbucks Rewards members.

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

This is Roz. Let me just mention some of the things that we’re doing from an operational improvement standpoint in the afternoon daypart. If you all recall, about a year ago, we introduced some labor deployment improvements at peak, and it’s been successful for us. And for the first time, we’re going to expand those through the full daypart. And this includes some of the lessons that we’ve learned at peak from the routines and the labor
deployment improvement, but it really goes a little bit further than that. We're specifically looking at tasks that are performed in the afternoon, and we're looking at the experience level of our partners in the afternoon. Typically, we've used our afternoons to train our new partners and to do routine tasks. And we often have a lot of our newer partners on staff doing their training. So over the coming weeks, we'll re-evaluate how our staff will use these hours and use the stores and the partners against more customer-facing initiatives. This will allow us to do really effective product introductions and then connect with the customer effectively. So we've learned a lot in that morning daypart, and we're going to take it throughout the full day.

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

John William Ivankoe
Analyst, JPMorgan Securities LLC

Hi. Two questions, if I may. First for Roz and the second for John, if I may. Roz, as you bring a broad perspective and a focus now on the Americas business, do you think some sort of a value strategy that fits within the overall lens of Starbucks becomes more important as we think about 2018 and 2019, and maybe bring back some of that non-core customer, and how may you be thinking about communicating price to the consumer? And a follow up after this if I may as well.

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

Actually I don't see a value position here. I actually think that our brand has the ability to speak even more at an up leveling. When we talk about product innovation, we talk about making our core coffee even better. When we talk about our Frappuccino business, it's about making the very best frappuccino. So a value position is not the direction we're looking at. We feel like our brand can go to the next level.

John William Ivankoe
Analyst, JPMorgan Securities LLC

Okay, and thank you, John, I think you're on the phone, as we look at China, and you're obviously doubling down with the consolidation of East China, presumably margins of CAP become higher than that at the Americas. I mean, you have a lot of G&A and growth cost, unit inefficiencies, pre-opening, what have you, in those numbers. But as you look out the next number of years, when might – firstly, will that happen? And when might that happen as we think about really the contribution from the vision over the next couple of years?

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

Maybe John, this is Scott, I'll start and then I'll turn it over to John to talk about why we think can drive outsized profit growth in CAP broadly and China specifically. So remember that our margin on that East China business today is probably in the triple digits somewhere, because we have half of the profitability, but just a fraction of the revenue. So when you take that highly profitable business and you do the new math with 100% ownership and the revenue denominator getting so much bigger, we'll see a little bit of impact at the CAP level on margins negatively while we go through the first year. And again, that's not because profitability goes down. You know this, John, but that's because of just the straight math of owning 100%.

Then I think you're going to see CAP once again grow margins faster than any of the other businesses. And I do think, over a number of years, we should see CAP catch the Americas and perhaps overtake. And the big reason that is, and I'll turn it over to John, is because of the inherent profitability of CAP broadly. So markets like Korea,
Japan doing well from a profitability standpoint. And, of course, first and foremost the profitability within China. John, you want to build on that?

John Culver
Group President, International and Channel Development, Starbucks Corp.

Yeah. And just to build on that, as we integrate East China into the operations, we really are focused in three critical areas. Number one, get the business integrated, but more importantly make sure that we’re in a position to accelerate growth and at the same time expand the margin. So, really looking at the operational efficiencies that we can gain with the acquisition and with the integration, particularly around supply chain, development and design, R&D, IT, and a lot of the backend infrastructure that currently exists in two different places as we operated a joint venture and then we operated a company-owned business.

And then the last piece is around gaining synergy and leverage around scale. And in particular, these areas are driving growth. Digital is a big opportunity. And if you look at digital and one voice to the customer across these markets, we see tremendous opportunity and runway for growth. Just to put it into perspective, we now have 6 million active MSR members across China. We’ve introduced WeChat and Alibaba Pay in our stores, and that is accounting to over 60% of the tender that’s coming through the stores.

Beyond digital, we’ve got beverage innovation and continued focus on accelerating the growth of beverage innovation through R&D that we’ve got on the ground. Food, and then clearly, a big synergy around operations and creating great customer experience across the entire portfolio. So, to Scott’s point, there will be a period during the integration where you’ll see a moderate decline on margins, but we will gain that back and very confident of that.

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

I just want to add one...

Howard Schultz
Executive Chairman, Starbucks Corp.

Hey John, this is Howard. I'm sorry, this is Howard. I'm just going to add a little bit of context to China and some of the things you said. As Kevin said, I'm in Milan and I'm working on the Milan Roastery with our design team. But on the heels of the record-setting opening of our Shanghai Roastery, I'd just like to bring it into context for you. I don't know how many store openings I've been to and how many countries we've opened. But in my long, long history at Starbucks, I have never ever seen anything remotely like what happened when we opened the Shanghai Roastery. I mean, we shattered every sales record in the history of the company.

And I'm going to give you some numbers that we have not yet released, because I think it's very important as we look at the difference between 3% and 2% comps for the quarter. I think, again, here's a number that I think you'll be very interested in. Our U.S. Starbucks stores, on average, do about $32,000 a week. The roastery in Shanghai, after eight weeks of operations, is doing on average twice that, not each week but each day.

So the volumes that we are now posting at the Shanghai Roastery is a number that we have never quite seen before, reaffirming the equity of the brand, reaffirming the interest our customers have in Princi, an opportunity that we feel is not only a domestic opportunity for standalone stores, but also an opportunity to leverage infrastructure and build Princi stores in China as well. But we just opened a store that is doing twice the amount...
per day that an average Starbucks is doing each week. That's the growth opportunity and that's the strength of the company in China.

I think we are at a disadvantage because most of you have not seen our operations in China, and I hope you'll come to the event in May and you'll see something that there's no other western brand, consumer brand that has accomplished with 3,100-plus stores with store opening every day, and numbers the likes of which we have never seen in our history. The roastery in Milan will open in the fall, the roastery in New York will follow, then Tokyo and Chicago. And all of this being integrated into the Princi stores that we feel so positive about.

So, I just feel like it's really important to once again just put into context that we are a global enterprise. Of course, the U.S. currently dwarfs the other aspects of our business. But what Kevin said is not a myth; it is true. China is going to be larger than Starbucks in the U.S., China is going to have more impact and grow faster than anything we've done in our history. And what we have seen in Shanghai with the roastery not only gives us confidence, but demonstrates the opportunity to be even larger than we once realized just a year ago.

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

Thank you.

Operator: Your next question comes from Jeffrey Bernstein with Barclays. Your line is open.

Jeff Bernstein  
Analyst, Barclays Capital, Inc.

Great. Thank you very much. Maybe just shifting gears for a second in terms of potential positive for the U.S. business or the Americas business. Just curious to get your theoretical thoughts on tax reform. And I know you guys and others have talked a lot about the corporate tax benefit, which seems significant. But in terms of the consumer benefit from tax reform, I was just hoping maybe you can give some insights in terms of historical or any kind of expectations you have. One, because the tailwind of a lower payroll tax is going to drive a higher paycheck for the consumer, and we're also seeing lots of corporates returning tax savings to employees by pay raises or the one-time stipend.

I'm just wondering, what would you even compare that to historically? Maybe – people talk about the gas-price savings and how that was kind of a one-time benefit. But how do you think about what could be a benefit for Starbucks or for restaurants maybe relative to broader retail in terms of the prioritization of that consumer spending?

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

Yeah, Jeffrey, this is Kevin. Look, we haven't gone into some deep study of how much does this increase consumer discretionary spend, and we haven't factored any of that into the future view. I mean, logically, you could draw a conclusion that increased discretionary income would increase spending on consumer items including food and beverage, and that could be good for us. But to be candid, we haven't studied that and I don't have any models or insight to share with you other than just general intuition. If consumers have more money then that must be good for consumer spending.

Operator: Your next question comes from Matthew DiFrisco with Guggenheim Securities. Your line is open.
Matthew DiFrisco
Analyst, Guggenheim Securities LLC

Thank you. I just had one point of clarity I just want to see, and then also just a question. Specifically to the $180 million to $220 million, Scott, I think you said that was – about half of that's going to come into 2018. So, is that a – that's a run rate number, so there'll be a bigger weight on 2019? And then also the 2019 tax rate, I think you said was going to be 300 basis points higher or at least beyond 2018 the tax rate is going to be 300 basis points higher. Is that correct?

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

The first part is correct, Matthew. So 2018, we'll see a little less than half of that $180 million to $220 million run rate, and 2019 we'll see a little bit more. And part of that is just because of the timing of some of the investments we'll make over the remaining course of the year.

On the tax rate, the numbers I was quoting was trying to reconcile you from our GAAP tax rate to our non-GAAP tax rate. The thing to think about is, our non-GAAP tax rate will be about 26% in both years. So about 7 points lower than what we had guided at 33% before the change in the tax law. So, that's a pretty consistent number as we look into the future.

Karen Holthouse
Analyst, Goldman Sachs & Co. LLC

Hi. Another question on the tax reinvestments. The language in the press release indicated that these were accelerating investments. And your part of the conversation for some time now has been build – you're talking about a multiyear cycle of investments that you're in. When we're trying to bridge 2018 to 2019, should we sort of be layering in on top of this incremental spend another $150 million or $200 million of partner investments, or how do these just fit into sort of the original plan?

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

Yeah, Karen, this is Kevin. Let me start and then I'll hand off to Scott, to add to this. But clearly, when we look at the tax reform and thought about the principles around this, the first principle we had is, this doesn't change our strategy. Our strategy is our strategy. We're clear on what we're doing. We're clear on the priorities we have. And so just because the tax law changed, does that alter our strategy? That was principle number one.

Principle number two, though, was looking at the implications to Starbucks of that tax change and making a thoughtful decision around allocation of resources. Is it a resource we could allocate to our existing strategy that we thought would help us accelerate progress against it. And then how do we make sure – and that principle was the second principle. The third was how do we make sure we do this in a balanced way? Are we investing in the things that are creating shareholder value? And the majority of this is going to drop to the bottom line and go straight to EPS.

So when we put that together, the number one area that you look at over the last several years that's been an ongoing multi-year strategy is our investment in partners and digital. And the bulk of that investment has gone into partners around things like wage and benefits, just knowing that certainly – with unemployment low and with
competing for the right kinds of talent, there's going to continue to be the need for us to invest in our partners. And we know in investing in our partners that we're able to attract the right people and we're able to have a lower attrition and longer tenure than others in the industry, which helps us better connect with customers and helps us drive sales. So we know that's a good investment to make.

In addition, we know and have line of sight to the return on investment on certain digital projects. And so, that is the work we went through to determine what — in the opportunity to make some additional investments in our partners, from some of the benefits and wage, and to accelerate the progress on some of these digital projects that lead directly to the way that we know we can connect with customers and drive comp and drive revenue and profit.

And so, that's kind of the principles and the construct that we came up with. And I'll let Scott then take it from there in terms of the implications financially.

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

I think Karen, I think this is definitely... Howard go ahead.

Howard Schultz
Executive Chairman, Starbucks Corp.

I know it's difficult, because I'm on a remote phone, but I'd like to just add something that I think is a strategic importance to the company long term, if you don't mind. I think if you look at the history of our public life, one of the, I think, real benefits of what we've been able to accomplish as a company has been the entrepreneurial DNA of Starbucks and constantly having the curiosity to see around corners and make big bets. And I think there's probably no better example of that than over the last five, six years, what we've been able to do and what Matt and his team has been able to do around digital, mobile payment, and our leadership position in what we've been able to accomplish as a brick-and-mortar digital mobile payment business.

I'd like to just pose a question to all of you and the question is, we all can probably remember 20 years ago or so when someone tapped us on the shoulder and asked us, do you know anything about this thing called the Internet? And we probably all can remember that moment. Well, 20 years later or so, the world has been completely transformed and we're all connected in ways that no one could have possibly ever imagined. And in terms of business and value creation, there have been some huge winners; we all know that, from Facebook to Google to Amazon and many others. And there's been some companies that have not done as well, the Myspace of the world, Yahoo!, and others.

Well, I think I have another question for you 20 or so years later and the question is, the issue of do you understand and are you anticipating what could happen with cryptocurrencies? And the reason I mention this is not because I'm talking about bitcoin because I don't believe that bitcoin is going to be a currency today or in the future, I'm talking about the new technology of blockchain and the possibility of what could happen not in the near term, but in the few years from now, with a consumer application in which there's trust and legitimacy with regard to a digital currency.

Now, I'm not bringing this up because Starbucks is announcing that we are forming a digital currency or we're investing in this, I'm bringing this up because as we think about the future of our company and the future of consumer behavior, I personally believe that there is going to be a one or a few legitimate, trusted digital currencies off of the blockchain technology. And that legitimacy and trust in terms of its consumer application will
have to be legitimatized by a brand in a brick-and-mortar environment, where the consumer has trust and confidence in the company that is providing the transaction.

And then you have to ask yourself, well, if that’s the case, if you believe that that proposition is possible, how many companies or what company has the national or global footprint as well as the digital mobile payment trust and confidence integrated into its existing business? And if you take it a step further and you believe this is coming, given the fact that there are hundreds of millions of dollars domestically and globally being invested in this technology in which there is an arms race as to who is going to win, there’s going to be a lot of winners, a lot of losers, but we are in a very unique position to take advantage of what other tech companies and the blockchain technology will provide in terms of the rails to potentially be in the mix of this and benefit financially, benefit in terms of consumer behavior and incrementality, and significantly create long-term shareholder value.

And I’m bringing this up because three or four years ago, I shared with you that I thought that we were heading into a seismic change of consumer behavior as a result of the Internet and e-commerce and the Amazon effect of things, and not that I was clairvoyant and I wish I wasn’t. But clearly, that has happened. I believe that we are heading into a new age in which blockchain technology is going to provide a significant level of a digital currency that is going to have a consumer application. And I believe that Starbucks is in a unique position to take advantage of that.

Now, I don’t want anyone to hang up on this call and assume that we have this all figured out because we don’t, or that we’re making a significant investment in this because we’re not. But we are actively demonstrating the level of entrepreneurial curiosity and DNA of our company to do the things that we’ve done in the past, to ensure the fact that we are at the cutting edge of this technology, of this consumer application. And we think we have something to offer the companies that are chasing this, because we are in a position to create the trusted legitimate place in which this could be accepted, and possibly take advantage of the mobile payment digital platform that we have created.

The one thing I would ask you not to do is, ask Scott lots of questions about this because this is not something that’s in our model. But I think it’s important as you think about Starbucks and you focus on our company, you understand that the growth of our company and everything we’ve been able to do for almost 50 years is not based on monthly comps or quarterly comps; it’s about the long view, about the entrepreneurial DNA of the company and constantly, constantly rejecting the status quo and doing everything we can to push self-renewal, reinvention, and really do everything we can to create the kind of relevancy with our customers not only on what we sell and the experience we provide, but ensuring the fact that we are at the cutting edge of technology as we were in the last five years with the digital payment platform and the rewards program.

I’ll leave it there.

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

Thanks, Howard. Scott, do you want to – the second part of Karen’s question was on the investments that [indiscernible] (01:19:20)

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

Yeah. And I think, Karen, the way to think about that is – Kevin said these were all on our roadmap, but I wouldn’t think that this displaces partner investments in 2019. Or said more clearly, we’re doubling down a little bit this year with partner investments, because it’s the right thing to do. As we get into 2019, I assume we’ll make additional
partner investments and we'll come back to you on the size and scale of that. But this wouldn't be in replacement of that, which I think is the nature of your question.

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

Jason West
Analyst, Credit Suisse Securities (USA) LLC

Yeah. Thanks. Just two quick ones. I guess, one, in the past you guys have talked about how much of the spend or what the spend growth was for your MSR members, and if you can provide that for the quarter. And then just to clarify the timing of the rollout of offering mobile ordering to the non-MSR, is that something that is going to be nationwide coming up here in the spring, or is it going to be rolled out gradually, starting at that point? Thanks.

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

I'll cover the first part, Jason, then I'll turn it over to Matt. So we saw mid single-digit kind of growth in our spend per members, so another really good quarter off the back of two big quarters. So we're pretty happy with what we've seen, particularly given the member growth we had in absolute numbers. Matt, do you want to cover the second part?

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

Sure. We're actually in pilot right now in the marketplace, so we are offering mobile order and pay to many customers – you can call it, a guest checkout, if you will, to many people who do not have the stored-value card. What will happen by the time we reach the end of March is we'll be able to scale that nationwide and make that available to all customers who are using our app.

Operator: The last question comes from Nicole Miller with Piper Jaffray. Your line is open.

Nicole M. Miller Regan
Analyst, Piper Jaffray & Co.

Thank you. Good afternoon. Just two quick ones, both on China. As you look at the brand identity there and the unit growth, are you seeing good treatments from landlords and stable rents in that regard? And then the second part is around the CPG business. So when you look at, I guess China, also look at Japan and places that – I think you're growing the international CPG product rollout. Is it a U.S. model or you want the stores first, or now does the model switch where you have enough stores and you have the Shanghai Roastery that you can go full-fledged forward with that, and that's something that also aids in brand awareness? Thanks.

John Culver
Group President, International and Channel Development, Starbucks Corp.

Yeah, Nicole, this is John. Real quick on the China piece. We are seeing continued very strong growth as it relates to our stores, and really the elevation of the roastery and the opening of the roastery, we have landlords coming from all over China to see that and they are reaching out to us asking us to bring our beautifully designed stores into their developments. So, we see tremendous opportunity to continue to accelerate the growth of new stores.
Our new store performance is the strongest that it's ever been. We opened 188 new stores in the quarter. We now operate over 3,100 stores across the Mainland, and we’re going to continue to accelerate the growth and we'll share more about that on our call next week with you.

And then in terms of the channel development business and how we’re thinking about growing channel development in these developing markets and in particular in China, as Scott shared, we sold 30 million bottles of Frappuccino since we introduced our partnership with Tingyi. Clearly, we have a strong retail brand footprint. With that retail brand, we're now extending out into the Channels business and into retailers as well as into the digital space as well. And we’re seeing that play out not only in China; we’re seeing that in Japan and then obviously strong growth coming out of our channel development business in EMEA. So, we’re excited to grow that business in parallel with our retail footprint.

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

So, I’d just add to John's points and maybe reflect back to a question that John Ivankoe asked about the growth of CAP. And just remember, in 2017 we saw China/Asia Pacific add nearly 50% of our overall operating income growth. As we think about this year, we'll probably be in that same range, maybe not quite as much because the Americas business is going to contribute a little bit more. But this is the twin engines of growth that Kevin talked about so specifically in his comments.

And as we look forward to 2019 and we get into the full ownership of East China, I think you're going to see that same kind of mix to the overall operating income growth. That's obviously driven by China, but within China/Asia Pacific, the other pieces of Japan and Korea as well. So, just make sure you remember that we're seeing a strong blend of profitability across those two businesses.

Operator: I will now turn the call over to Mr. Shaw for his closing remarks.

Tom Shaw  
Vice President-Investor Relations, Starbucks Corp.

Great, thanks. Before closing today's call, we wanted to provide an update on the timing of several upcoming events. As mentioned in our earnings release today, we will host a supplemental call to discuss our business in China as well as implications from a modeling standpoint next Wednesday, January 31 at 2:00 PM Pacific.

In addition, we wanted to provide the specific dates of our China Investor Tour that Howard mentioned. We plan to host management meetings, local store tours and a visit to the roastery in Shanghai on May 16, with plans to visit a second market the following day on May 17. And finally, we are tentatively planning our 2018 Investor Day in New York on Wednesday, December 12. Thanks again, and have a great evening.

Operator: This concludes Starbucks Coffee Company's first quarter fiscal year 2018 earnings conference call. You may now disconnect.