

15-May-2018

Starbucks Corp. (SBUX)

Investor Day

CORPORATE PARTICIPANTS

Tom Shaw

Vice President-Investor Relations, Starbucks Corp.

Jeff Miller

Vice President Coffee and Partner Engagement, China and Asia Pacific, Starbucks Corp.

Alan Tong

Director- Starbucks Farmer Support Center, Starbucks Corp.

Kevin Johnson

President, Chief Executive Officer & Director, Starbucks Corp.

Belinda Wong

Chief Executive Officer-Starbucks China, Starbucks Corp.

Leo Tsoi

Chief Operating Officer, Starbucks China, Starbucks Corp.

Emily Chang

Senior Vice President and Chief Marketing Officer, Starbucks China, Starbucks Corp.

John Culver

Group President - International and Channel Development, Starbucks Corp.

David Hanson

Asia Vice President and China GM, Starbucks Corp.

Weiwei Chen

Vice President and Chief Financial Officer, Starbucks China, Starbucks Corp.

Scott Maw

Executive Vice President & Chief Financial Officer, Starbucks Corp.

OTHER PARTICIPANTS

David E. Tarantino

Analyst, Robert W. Baird & Co., Inc.

John Glass

Analyst, Morgan Stanley & Co. LLC

John William Ivankoe

Analyst, JPMorgan Securities LLC

Jeffrey Bernstein

Analyst, Barclays Capital, Inc.

Karen Holthouse

Analyst, Goldman Sachs & Co. LLC

Jonathan Clifton Conley

Analyst, Stifel, Nicolaus & Co., Inc.

Nick Setyan

Analyst, Wedbush Securities, Inc.

Dennis Geiger

Analyst, UBS Securities LLC

Matthew DiFrisco

Analyst, Guggenheim Securities LLC

MANAGEMENT DISCUSSION SECTION

Tom Shaw

Vice President-Investor Relations, Starbucks Corp.

Good morning everyone, and welcome to Starbucks 2018 China Investor Day. So I'm Tom Shaw, Vice President of Investor Relations and on behalf of our whole Starbucks team from Seattle to here in Shanghai we want to express how excited we are that you could all join us today for our first ever international investor event.

Before we dive into our presentations today, I have just a few housekeeping items to cover. First, for those in attendance, we have provided a one page outline of today's events that will include all those important details you guys like to see like Wi-Fi access and restroom locations. Second, let me give you a quick framework of the day and I'll pop up here a few times throughout to give you kind of updates as we move along. So to start a day, we'll have initial presentations that last roughly 90 minutes, we'll then have a short break before returning for our final speakers and then we'll wrap it up with Q&A.

And finally for everyone in attendance and participants on the webcast, please take a moment to review our forward-looking statements that will apply to today's conversations.

So to kick-off our day, we'd like to share a quick video for everyone to highlight some of our history and early success here in China. Thank you.

[Video Presentation] (00:01:18-00:05:00)

Jeff Miller

Vice President Coffee and Partner Engagement, China and Asia Pacific, Starbucks Corp.

Good morning, and welcome to Shanghai. My name is Jeff Miller. I'm a 23-year Starbucks partner. I just returned to our China business a couple of weeks ago to look after retail operations and coffee engagement. I'm very proud to say that I've spent 9 of my 18 years in Asia as a part of the China team.

By now you should each have a cup of coffee in your hands. Please enjoy the aroma and feel free to give it a taste as we share the story of this coffee with you. You probably already know a lot about what Starbucks China is known for. But today we want to share a story with you that you may not be quite as familiar with. This is about a journey that starts about 1,700 miles to the southwest of here and ends with a cup of coffee that's in your hands.

To kick off this special gathering, we want to take you to Pu'er, in the rolling foothills of Yunnan Province and share with you the efforts of our partners there to improve the quality of Arabica coffee. In only six short years, Alan Tong and his team have succeeded, where no one else has, where less than a decade ago Yunnan coffee was primarily used in mass coffee products around Asia, Yunnan arabicas can now be found increasingly in specialty coffee houses around the world, including most recently as a reserve feature at our Shanghai and our Seattle Roasteries. This is largely because of the work of our Farmer Support Center and our dry mill operations. And this is only the beginning.

But as important as the coffee is itself is the source of pride that Yunnan coffee is provided for our partners and our customers. And we're very excited to share this with the world. So this morning it is a joy to share this with all

of you, and it is my privilege to introduce Alan Tong, our Director of the Farmer Support Center and dry mill operations in Yunnan.

Alan Tong

Director- Starbucks Farmer Support Center, Starbucks Corp.

Good morning, everyone. The coffee in your hand is from Yunnan. Can't you taste the good sweetness and the citric acidity; it is very, very balanced with some green tea like note. I roast it for you, and brought it to you from Pu'er, where we have a 1,700 farms with 17,000 hectares verified through all C.A.F. E. Practice.

In 2012, we started our coffee journey by establishing the Farmer Supply Center the dry mill. We have 4 agronomists in the FSC and a 33 operational staff in the dry mill. They both have very perfect collaboration like a Yin and Yang in Tai Chi. The FSC gives the trainings and support and the dry mill gives the premiums for the good quality.

Over the last few years, my team and I will spend most of the time in the vehicles, driving from one farm to another, getting to know the farmers, helping them, building the trust in order to get to where we are today. Now it makes us the buyer of choice to the local farmers, with an annual purchase increment by 7 times or 8 times, than the year of 2013, when it was only 1,000 metric tons only.

I'll never forget that, no one knew about Starbucks at the beginning. I was confused, really? Am I going to Michael J. Fox in The Back to the Future 4? The first time training that we had with the farmers, it was only 25 people. And I had to treat them with a very delicious dinner after that. Even today, I'm not so sure what made them come for the training, my charm, or to have dinner. And last November more than 4,000 farmers drove for hours to the farmer assembly, and taste their food of the labor and celebrate their dedications to improve the quality for Yunnan coffee.

Being a leader in my dictionary has two important key words that is leverage and change. With the years of hand-in-hand hard work with the farmers, we're already part of the extended family and the leverage is constant. We could see many positive changes not only to their livelihood, to their farming practices, to their quality awareness, but also to the recognition by the world for Yunnan coffee. Starbucks is going to elevate Yunnan coffee industry and that is for sure. The first 10 feet is not a long distance, however it takes us six years to get it here. Please let's take another slip of this coffee especially for this occasion for you.

Today, we are so proud of that we have our own Roastery in China where we could have our best Yunnan beans to be roasted and delivered to our stores for the customers to enjoy. Let me introduce my partner from the Shanghai Roastery, [ph] Hong Hong (00:10:13)

Unverified Participant

Thank you, Alan. Good morning all. My name is [ph] Hong Hong (00:10:17). I'm Starbucks coffee roaster at Shanghai Roastery. It's such a big honor to share our Yunnan coffee here. I still remember the first time when we roasted the Yunnan coffee at Shanghai Roastery, the eight of us, the first bench of China roasters had just finished out training and returned to Shanghai from Seattle. We were very excited, yet nervous about roasting this coffee, that's so close and dear to our hearts. We discussed about roasting plan again and again with our master roasters. Trust me you will be amazed if I show all our ideas and the plan we went through.

When the first Yunnan coffee bean came out from the roasting machine, we cheered, we hugged each other, we cried. What an incredible moment. The Chinese coffee, roasting China by Chinese roasters, can you imagine how proud we were. You probably can tell how proud I am right now. So if Alan's team give Yunnan coffee life, I wish we roasters can give Yunnan coffee a great stage. It's just like Starbucks always does to us partners, we are not just roasting coffee, we help coffee to show itself to partners, to customers, to you and to the world. We like coffee speaks for itself. Please enjoy this unique balance of this Yunnan coffee.

I'll now pass it on to George, who present our Chinese barista and to tell you what Yunnan coffee means to them. Thank you.

Unverifiable Participant

Thanks, [ph] Hong Hong (00:11:46). Hi, everyone. I'm [ph] George (00:11:48) and I'm from Kunming, the capital City of Yunnan. I started my Starbucks [ph] journey (00:11:52) in September 2012 as a part-time barista when I was a junior in [indiscernible] (00:11:56) and now I'm a store manager of the first reserve store in Yunnan. I'm very, very proud to share the Starbucks model of reserve coffee to our customers in such a unique location.

My partners and I enjoy using different brewing methods to present the best coffee to our customers. I remember the first time when my partners and I tasted the Yunnan reserve coffee beans we were stunned by its unique herbal flavor. I want to know more about the Yunnan coffee beans, I can share with my partners and customers. Later on, I had a chance to visit the Farmer Support Center in Pu'er and all my questions about Yunnan coffee beans were answered. I get to know every single step involved, but the biggest takeaway for me was I realized every Yunnan coffee bean is a result of the hard work of Yunnan coffee farmers and our partners from the Farmer Support Center.

After I went back to my store, I hosted a special coffee tasting to share my experiences on the [indiscernible] (00:13:03) coffee with my customers. That day we sold out on all the Yunnan coffee beans in my store. My partners and I are honored to use our skills to present the Yunnan coffee to our customers in the last 10 feet.

Jeff Miller

Vice President Coffee and Partner Engagement, China and Asia Pacific, Starbucks Corp.

Thank you very much, [ph] George (00:13:18). This is the China seed to cup story that makes our partners and our customers so very proud. And what you've just heard is a true testimony to the passion and the dedication that our partners have for everything that we do around coffee here in China.

So thank you very, very much for sharing in the special coffee with us this morning. Thank you. And it is now my great honor to introduce our CEO, Mr. Kevin Johnson, and welcome him to the stage.

Kevin Johnson

President, Chief Executive Officer & Director, Starbucks Corp.

Yeah. Thank you. Thank you. Thank you. Give him a round of applause, what a wonderful coffee tasting. Thank you so much.

Well, good morning everyone and welcome to China. It is an honor to host all of you here for this two-day event. I mean this is the first time we had the opportunity to host a China Investor Conference. And I must say I had visited China many times, numerous trips here. And it really is a second home to Starbucks. But I must say it's

very difficult to describe the experience that you have here in China. You must experience it in-person. And so, I want to begin by thanking each of you for traveling and investing the time and the resource to be with us over the next two days.

Now, Belinda Wong and her team have prepared a wonderful journey for you. This journey, I guarantee will make it worth your time. And to really understand Starbucks China, you must experience it. And over the next two days, you will have an immersive experience on all aspects of China. Jeff and the team shared a little bit about the work we're doing in Yunnan around origin. You're going to have an opportunity to immerse with our store designers, with our product R&D, with our digital ventures, with our partner resources team, and our channels team. Every aspect of how Belinda and her team bring the Starbucks Experience to life here in China.

Now let me set a little context before we begin. This represents a long-term growth opportunity for Starbucks. And we've been in China for 20 years now. And we have built this business in China for China. In fact it is clearly one of the top priorities, and it requires focus, requires discipline, and it requires us continuing to take the long-term view. Now this past year we've worked at the enterprise level to really amplify our focus on the core value drivers for you our shareholders.

And let me summarize three things that I believe are supporting our agenda here in China. I want to take an opportunity to share a little perspective on streamline, and how the streamline efforts are helping us really amplify the core value drivers especially here in China and the U.S. I want to share some thoughts on the global coffee alliance that we announced last week, and specifically how that global coffee alliance can also support our agenda here in China.

And then third, I want to just share a little bit about how this amplified focus on value creation combined with the management philosophy that we use to really empower Belinda and the team you're going to spend the next two days with to run this business in China. There is more innovation coming out of Starbucks China than any other market in the world. And that is much about the leadership team, the way they're empowered and we're going to take you through that over the next two days.

Now, let me just start by sharing a little bit about streamline. Over the last year, we have communicated consistently with you about our activities to streamline the company, so that we can focus more of our energy, more of our capital, more of our resources on the core value drivers going forward. I think about streamline around three main pillars; retail alignment, business simplification and this global coffee alliance.

Now specifically retail market alignment really is representative of the fact that we have been aggressively licensing retail markets that have either lower returns on invested capital or lower upside in terms of new unit growth. Examples have included markets like Germany, Singapore, Taiwan and Brazil. We've transitioned in those markets over 800 stores from company-operated to license stores. And in addition to transitioning some of these markets to licensed, we have also deployed capital to acquire 100% of the joint venture in East China. That is enabling us to now unify all of Mainland China around a company-operated model and create some synergies that Belinda and team will take you through later this morning.

Now the second pillar, business simplification is really about either divesting of non-core slow growth assets and simplifying our internal business operation. We sold Tazo tea to Unilever, so that we could focus on our core premium tea brand Teavana. We also closed the Teavana specialty retail stores in the U.S. and North America realizing that the place we were selling over \$1.6 billion of Teavana was in Starbucks stores. And as we took Teavana globally in Starbucks, that was just fuelling additional growth. We also optimized items for sale in our stores in the U.S. through a SKU rationalization process and that resulted in roughly the reduction of about 30%

of the SKUs that we sell in the lobby and some efficiencies that we have on the food and beverage side. The business simplification is allowing us to get more efficiency and put more of our energy behind core value drivers.

Now the third pillar is something we announced just last week, which is a global coffee alliance with Nestlé. Now this is an opportunity to significantly accelerate our international CPG and foodservices business. Now I think about this in many ways when we opened Starbucks stores in a market, we established the brand, and that brand is established by the fact that customers come visit our stores and the experience we create for them in the stores sets the tone for the Starbucks brand.

Now, we've demonstrated in the U.S. and Canada that when we complement the work we do in our stores by selling Starbucks products at grocery, mass merchants and foodservices, it becomes a brand amplifier. So the customers that understand the brand from their experience in Starbucks have an opportunity to purchase and sample a wide range of different Starbucks products at grocery, mass merchant, foodservices, that strengthens their affinity for the brand and brings them back into our stores. There's a synergistic approach between CPG foodservices and our Starbucks re rust resistant tail business.

Now we've proven that in North America where that business has just been on fire for the last seven years as we've grown that as we've built that business. But candidly, we're in 76 countries around the world and having a CPG foodservice success in the U.S. and Canada means there're 74 other markets where we have established the brand, but either the CPG and foodservices business is nascent or nonexistent. So this global license agreement with Nestlé allows us to continue to control our brand and at the same time Nestlé will leverage their massive scale and capabilities for global distribution. This licensing partnership includes an upfront payment of \$7.15 billion to Starbucks as well as ongoing royalty and product fees to provide meaningful economic incentives for both companies. We are incented to continue to grow this both strategically and economically.

Now that growth will come in a couple of ways; one, our expansion globally into new international markets. Nestlé brings over 5 million points of presence in 189 countries. Now certainly a subset of those points of presence are going to be places that are very applicable for Starbucks products to be sold. And so our opportunity to go market by market and build a thoughtful plan about how we're going to enter that market with the right products, the right points of presence and we will prioritize that following the close, we'll work with Nestlé on the next wave of plans we have to expand that. But that's growth, growth opportunity.

The second aspect of growth is the fact that Nestlé is opening up Nespresso and Dolce Gusto systems platforms for the first time to Starbucks coffee. Now let me just remind you that Starbucks sold our first K-Cup on the Keurig platform seven years ago. We became the number one premium brand on K-Cups in United States on the Keurig platform within four years of getting on that platform. And we've continued to grow share every year since then.

Now today the Keurig platform is focused specifically on North America and we're going to stay on the Keurig platform, but the fact that Nespresso and Dolce Gusto platforms are global means that the installed base of systems that they have on a global basis far exceeds that of Keurig. And so our opportunity to grow not only by geography, but by new products on the Nespresso and Dolce Gusto platforms opens up a huge opportunity.

Now the third aspect of this global coffee alliance is around sustainability. We share a commitment to make coffee the first sustainable agricultural product. And this means that we have an opportunity to embrace C.A.F.E. Practices that ensure that farmers get paid equitably for the coffee they grow. We have the opportunity to collaborate on the agronomy research that both companies do, and to leverage our Farmer Support Centers in an open source model to share what we learn to help coffee farmers around the world improve their yields, embrace

hybrid coffee trees that are rust resistant and help ensure that we continue to facilitate and embrace coffee farmers to grow the world's finest coffee.

Now, all of these streamline actions have netted in aggregate approximately freed up about \$8 billion of capital. Approximately \$8 billion of capital freed up through the streamline actions that we've announced. Now, we've redeployed \$1.3 billion of that capital into East China, and you'll hear more about that today. But the net of all streamline activities that we've done are accretive to both revenue and EPS in fiscal 2018 and 2019. And they have been able us to increase our cash return to shareholders to \$20 billion over the three years fiscal 2018 to 2020.

Now, all of that is allowing us to focus much more on China. Now from the moment, we opened our first store in China in January 1999, we've been playing the long game. We've built and maintained a company that has a deep respect for the Chinese culture, our customers and the partners who proudly wear the green apron in more than 100 cities throughout China. No western company or brand is better positioned to benefit from the rapidly expanding Chinese middle-class. And certainly, we continue to be mindful of the fact that we will evolve a coffee culture in China where the reward will be healthy, long-term profitable growth for decades to come.

The extraordinary Shanghai Roastery which we will host you out this evening is building on our long history in China and it continues to exceed all expectations. Now the financial returns from the full acquisition of our East China business are already running ahead of our internal guidance and it will contribute 2 points of EPS growth this year. And that profitability and that momentum should accelerate as we move into fiscal 2019 and beyond.

Now the leadership team you're going to see here today is fully integrating and optimizing this for the future. In fact Starbucks manages, we invest in, and we grow our brand with a global focus. We're playing a long game. And Belinda and her team have done a phenomenal job and brought the Starbucks brand to life here in China in a local way and that gets to the management philosophy. You know many times I have to decide what are those things that we do globally and what are those things we do locally. Certainly our mission, our core values and our brand are things that we embrace globally. But when it comes to everything else in China, it is done locally. Belinda and her team are fully empowered to respond, to react, to adapt the Starbucks brand here in China, which is why over the next two days you will see that we have integrated the entire set of leadership functions needed to run China in a way so that China is built here in China for China. The Store Development team, the Product R&D team, Supply Chain, Digital Ventures, Partner Resources, Channel Development, all contain within the China leadership team that you will meet here in the next two days.

And I will tell you, the pace of innovation that's taking place in China especially in Starbucks China is exceeding any other market in the world. We learned so much from the work they do whether its work they've done around store design, and the fact that we have over 140 Starbucks Reserve bars here in China. They invented the concept, and it's a concept we're now taking globally. You look at the work they've done on digital. They embrace social gifting, and you look at the fact that over 60% of their tender is now paid for through the mobile app, innovation, product R&D. We're going to take you through our R&D lab later this morning or later this afternoon and you'll have an opportunity to sample some new beverages and get a sense of the work that's going on here from an innovation standpoint.

So this next two days is all about Belinda and her team. It's their show, and they are empowered and I am just here to serve them. So it is my pleasure to introduce you to the CEO of Starbucks China, my friend and great partner, Belinda Wong. Belinda?

Belinda Wong

Chief Executive Officer-Starbucks China, Starbucks Corp.

Thank you. Thank you. Thank you, Kevin. Hello. Thank you, Kevin. Good morning. Welcome to China finally. And welcome to Shanghai Support Center and welcome to our home. So, so happy to see you all here. Very excited to be able to share with you in-person, our ambitions and in Starbucks fastest growing and most strategic international market.

The extraordinary business performance that Kevin mentioned just now in this market did not happen by chance. It is the result of the love, pride and dedication of our 45,000 Chinese partners. Each critical pillar of our business is led by some of the most talented and dynamic leaders in the market on my leadership team. And you've already heard from Jeff – Jeff, where are you -Jeff, about our passion and pride for all things coffee and how we want to help bring the best of China's coffee to the world stage.

It is my privilege to formally introduce you to the other members of my awesome leadership team, the China leadership team. Stand up; you've been working really hard. Leo Tsoi, our Chief Operating Officer – you guys can come up here, they can't really see you. He's also leading store development and supply chain for China. Emily Chang, our CMO, Weiwei, our CFO, I'm sure you love to talk to her and you've the chance; Laura, heading our Partner Resources, Laura, wave; Victor Cui, the guru heading our Public Affairs, everything Government Relations; Linda Zhang, R&D, heading our R&D Quality Assurance Regulatory; Mr. James Wei, our China Technology guy. Buay Beng Tan, this is the person you want to talk to, because she's heading our East China Integration and East China business. Jason, where are you? He's keeping us legal in this country, heading our Legal Function. Jane Lau heading our Food Business, Molly, she has the best job in the company heading Digital Ventures. Grace, she's the person who created the Shanghai Roastery and heading the Siren Retail and Mr. David Hanson soon become a Chinese, heading our Channel Development business. Thank you. Thank you all.

So over the next two days you'll be able to interact with them in person. And I know each one of them is dying to share with you their own Starbucks story and their excitement about the opportunities ahead. Almost 20 years ago Starbucks pioneered the specialty coffee market in China. We introduced a unique 3rd place experience in serving high quality coffee to our Chinese customers.

Fast-forward to today, no other coffee retailer in China has the depth of our coffee expertise or the breadth of our store footprint, partner experience, product innovation and positive impact in the community. The Starbucks Experience and the personal moments of connections our partners have with our customers 6.4 million times every week simply cannot be replicated.

So how did we do this? You heard from Kevin before that Starbucks has cracked the code in China. I would love to humbly, humbly share with you our experiences and learnings. As you sit here this morning, there are 3,300 stores across 141 cities in Mainland China. We're not just opening a new store every 15 hours, but a new store that is profitable and with great returns. This did not happen overnight and it is a result of our discipline growth. We tested our ability to accelerate our growth with no, no compromise on our values and commitment to deliver the unparalleled partner and customer experience.

Today we have the world-class capabilities to open hundreds of new stores every year. China is a very, very dynamic market. It requires us to learn from each new store opening and innovate to build the next one better. And one of the most strategic investments to enable our accelerated growth is our own China design studio with a 120 very, very talented designers, we have delivered newest class of enticing and welcoming stores that is outperforming and delivering record transactions and profits far, far above any of our peer set.

We've also established Starbucks as a tenant of choice. We have developed many strategic partnerships with premium landlords. This is giving us unprecedented access to some of the most sought after retail locations, all across China with the most preferential terms. Our stores are located in some of the most high traffic, prime lifestyle locations and malls, transport hubs and the finest commercial centers. This too cannot be easily replicated.

China was a tea drinking country when we entered the market back in 1999, and it still is. We had to learn how we can introduce a specialty coffee culture lifestyle to our customers. We listened intently to the needs of our customers to translate the unique Starbucks Experience in the locally relevant way. We have to stay agile, and have the capability to innovate. This commitment to innovation led us to open the first Starbucks R&D Center in Asia right here in Shanghai. This is another, another strategic investment we made to unlock our dayparts with the right food and beverage offerings. 85% of our beverage offerings are created in China, for China, and we're developing 100% of our local food offerings.

While I see a great potential in our morning business, I love the fact that our dayparts are so balanced. We have an equally strong lunch afternoon and evening business. Our passion and our focus is to continue to enrich each and every day-part and lift the entire base of transactions throughout the day. We take the authentic relationships we have built with our partners, customers, strategic suppliers and other key stakeholders like government and media very, very personally. We have to continue to earn our trust and credibility every day. Success is certainly not an entitlement. We need to earn and preserve those trusted relationships and friendships. That is what makes Starbucks so well integrated in the fabric of the Chinese society.

The Shanghai Roastery, where we dreamed up and landed a never before seen innovative experience is one of the best, best reflections of the incredible relationships we have built with the local government. Starbucks and our Shanghai Roastery have been quoted on numerous occasions by the government as the role model to support the country's innovation agenda. I think we've done a pretty good job so far in translating the Starbucks Experience locally and you'll you hear more from each of our speakers later.

Right from the beginning, we wanted to be a different kind of company. We want to be a purpose driven company in China, taking real actions and responsibilities to role model what a full profit company can do for its people, society, and for my country. What makes me most excited about our new store openings is our ability to promote a new store manager every 15 hours, a new district manager every week, and an area director every quarter. We're doing our part to train the finest retail leaders for of the future, the best people leaders with great business values and ethics for my country.

And we're also creating over 10,000 new jobs every year. The better we do, the more we can invest back to our people and communities. We, our 45,000 partners all share the same purpose, pride and beliefs. The purpose-driven culture is what skews our passion and energy to do what we do every day. We want to achieve something bigger than ourselves. Unique to Starbucks in China is the culture of family, a value that is deeply rooted in the Chinese tradition.

As we continue to accelerate our growth, we recognize our increasing responsibility to leverage our scale, to innovate around the partner experience and also to take great care of their families. Success is best when shared and we've launched many unique partner benefits in China already. We went beyond what most companies would offer to their people here. We have the same comprehensive life, accidental and medical insurance benefits to the spouses and children of our full-time partners. We also pioneered first of its kind critical illness insurance program for the parents of our partners. In my opinion, there is truly no other retailer like Starbucks in China. Everything

that we've done has been laying the foundation for a much, much bigger dream. We're so excited about the enormous opportunities ahead.

I've spoken extensively in the past about the significant growth opportunities and the synergies or efficiencies we'll gain through the integration of our East China business, and additionally, with the rapid pace of the economic growth development taking place across China and the rising middle class with much higher disposable income will undoubtedly drive the coffee consumption growth here in this market. All this will boost the demand for Starbucks. We're so confident for our long-term growth and development in the market.

With that I'm proud, very proud to share with you our purpose-driven China growth agenda. Centered around our partners, their families and communities, we will be laser-focused on strengthening local relevant innovations experience and moments of connections with our 3rd place strategy, built even deeper relationships with our customers and the 4th place with our digital flywheel, and extending our brand reach by weaving the Starbucks Experience into the fabric of the Chinese millennial lifestyles through Starbucks On-the-Go. These three pillars together with our aspirations to get give back to the Chinese communities are our purpose-driven China growth agenda, and we will be obsessed in delivering with results and pride in the coming years.

The 3rd place strategy is a holistic multi-sensory approach from the location, store design, food and beverages, partners and customer connections all the way to how our baristas passionately show off their craftsmanship and knowledge on coffee. This is the theater for the ultimate Starbucks Experience and we excel in this area by far. And that is why our brand resonates so well with our modern Chinese customers. It's also the reason why the brand triggers so many Instagram or WeChat moments. But the needs are forever evolving and we need to continue to push the envelope to exceed the expectations of our customers. Leo will share in details what we've been doing, and the focus of our efforts going forward to fuel our growth in that area.

While it is important to win in our 3rd place, it is equally important to win in the 4th place, the digital space. Chinese consumers now are among the most digitally savvy customers in the world. The 3rd and 4th place need to complement each other and redefine the new retail experience, and Emily will share our plans to make the 4th place an integral part of the complete Starbucks Experience. And then I'll have David Hanson to wow you with a runway for growth ahead to build our distinctive made in China for China On-the-Go business portfolio. Last but not least, you will have – you'll love to hear from Weiwei, our CFO who will share with you our disciplined growth approach and the financial health of our business here.

In closing, it has been an absolute privilege to lead this unprecedented era of growth and be able to work with our fine partners here who care so deeply brand and for each other. My optimism for the China market has never, never been greater. A collective hard work and investments made in the past 20 years has set the perfect foundation for us for our future.

With that I am thrilled to announce that we will be accelerating on our store growth. Starbucks China will set a new goal to double our store count to 6,000 stores in over 230 cities across the Mainland by 2022. That means we're going 20% faster, growing 600 net new stores annually starting this fiscal year and entering into an additional 100 new cities. We're still in a very early stage, beginning chapters of our purpose-driven growth story here in China. We will continue to create history with Starbucks Coffee Company and I promise you we will one day be larger than the U.S. market. Thank you.

Now it's my pleasure to introduce to you one of the heroes behind the early success in Starbucks China, my great friend and our Chief Operating Officer, Mr. Leo Tsoi.

Leo Tsoi

Chief Operating Officer, Starbucks China, Starbucks Corp.

Thank you, Belinda. Good morning, everyone. I'm Leo Tsoi, the Chief Operating Officer of Starbucks China. Welcome to Shanghai again. I'm delighted to share with you our strategic growth initiative to elevate our 3rd place strategy. I joined Starbucks China in 2012. I was born in China and educated in Hong Kong. I love our country and I'm incredibly proud to come to China to serve the Chinese people with my understanding of China and my brand and commercial experiences from P&G, Starbucks Asia-Pacific and PepsiCo.

After 15 years in China, I continued to be proud and inspired by how our country is developing on a daily basis. In fact, this uniqueness requires us to view the Starbucks brand in a dynamically different way. And let me share with you some of the insights that we have been seeing over the years. China's middle class population is expected to double to 600 million by 2022. Today 415 million millennials in China aged between 18 to 38. While the middle class is known to be strivers, the Chinese millennial are known amongst the most well-educated and well-traveled. They seek innovative experiences to fulfill their aspirational and global lifestyle, but they also have very strong pride and respect for the Chinese culture and heritage. And this is why, our holistic made in China for China 3rd place experience has a strong appeal to them.

Also you must remember one important fact, the nearly 115 million of the population, half of the size of the U.S. population, who was born under the China's one child policy between 1980 to 2015, this generation, they crave human connections, either with their friends or to spend quality time with their friends and families. The sense of community that our partners have created in our 3rd place will be more relevant and important in the years to come. This aspirational consumer lifestyle needs will continue to be the driver of our creation of our future innovations.

And there are three key growth drivers. They are important to elevate the purpose-driven China growth agenda. Number one is to drive the penetration in breadth and depth to meet the increasing and evolving in each stage, and importantly, to acquire new consumers. Second, it is to double down on our innovations plus inspire new occasions and increase frequency. And last but not least, it is to elevate the Starbucks Experience to premiumization.

Now, let me explain how we're going to interpret these drivers into 3rd place strategy. With one store opening every 15 hours, Starbucks China has tripled our store count to almost 3,300 stores in the past four years. This record store portfolio growth far exceed our peer set and is on par with our U.S. market in the early days of the statutory growth. We have learned and continue to fine tune our skills and ability to balance the existing store sales with new store growth. And you are seeing almost all the stores across China have achieved that profitability and solid financial performances and profit growth. And this is the result of our successful network growth strategy with a discipline to go wide in the new cities and our intentionality to innovate in the city when we go deep.

Our going wide strategy requires a holistic approach of course the functions and carefully consider and analyze in each and every city that we enter. Behind me are the photos of the first store opening in a city like Xiangyang, Hubei. Look at the enthusiasm of our partners and the long lines of customers waiting to enter our store when we first opened. This amazing and excitement seen has actually happened over 70 times in the past five years when we enter the new cities. In fact, we do know that all of them have achieved a profitability starting from the first year. As Belinda just announced, we will bring the same experience and our approach to another 100 new cities by 2022.

Let me remind you another important fact. The majority of these new cities are home of an average of 4 million people approximately equivalent to the size of Los Angeles. Everyone, what this means is that we are going to be introducing the Starbucks Experience to a population nearly 100 times of Los Angeles in the next five years. Now how can I not be excited with this amazing runway of growth ahead.

Now let me also share with you our strategy to deepen our existing stores when we enter the cities. We grow with our customers, with our Starbucks Discovery journey. We intentionally elevate our store profile and portfolio as we scale in each city. Importantly, we also introduced new concept and new format in the city, where we open our store to enhance our reach and deepen our connection with our customers.

Our customers' first engagement with Starbucks is typically through our beautiful core store. Now as they grow, we begin to strategically curate relevant experience to exceed their evolving needs. One example, it's the brew bar. They were pioneered back in 2013. Now brew bar, it's an engaging handcraft platform that we use [indiscernible] (00:54:04) the brew to handcraft our beautiful cold coffee such as Kenya and Sumatra. We deliberately make our brew bar low, close and neat because this is the stage where we handcraft pace, share the passion, share the love and the quick taste of our beautiful coffee with our customer one-on-one. And over the years we've refined our brew bars by up leveling the brewing technique, but we also push ourself hard to keep its simplicity, because we know the key is to enable this connection between our partners and our customers when they are in brew bar.

Now, I'm so proud to share with you we have been introduced brew bar in more than 1,000 stores in China. This high level engagement of brew bar actually inspire us to evolve this experience when we introduced the Starbucks Reserve brand in 2014. Now when a city and our customers are ready, we will introduce the Starbucks Reserve bar to invite our customers to lean further to an even more premium experience.

Our brew bar brings to life an even higher level of coffee craftsmanship and importantly showcase we can go beyond the product experiences by delivering an elevated multisensory experience when people are in the store and only the certified red apron coffee masters can operate our brew bar and brew and handcraft our premium reserve coffees. And today we showcase our reserve coffees in over 150 Starbucks stores in the Reserve bars in China. And we expect to reach 200 stores of our Reserve bars by the end of fiscal year 2018, but that's not all. We need to constantly evolve ourselves with our customers, as we continue to expand in the city.

For example, the Chinese customers are probably some of the most mobile consumers in the world. China has the world's largest railroad network; four times bigger than Japan. So we are building more stores in transport hubs across our cities to serve the 1.5 billion passengers passing through these 5,500 hubs every year. Additionally, we are also introducing new core stores with different formats and profile to elevate the Starbucks Experience with the rising middle class. Our residential store format; it's actually a neighborhood store, built with and designed with the comfort of a living room and a self-do bar where our partners and our customers hand you coffee side-by-side. You're looking at a store that we opened last year in a community in Guangzhou, Jinxiu, with 20,000 residents, and similarly our new pet friendly store invite our customers to come up for a coffee with their [indiscernible] (00:58:15) friends.

So each and every of this format actually are decide intentionally to create more occasions to build a daily coffee ritual. And then there is our flagship portfolio, our flagship is, the statement of our brand in China. It's a complete multisensory theatrical experience at the next level. Since our first flagship opened in Beijing Kerry Center in 2013, we now have six flagship stores built and opened across China. Successful programs such as our bar element, product offerings are all replicated across the regions.

We learn from each other to make the next one better and even with more inspiring and innovative experiences. And today I'm so excited to share with you our latest flagship evolution, the Beijing Fun store opening soon in June in Beijing. This is the largest store aside from the Roasteries. It is the store 1 km away from Tiananmen Square. With this 10,000 square feet space, we are featuring three distinct craft bars. The Reserve bar on the ground floor, and then Teavana bar, and then Mixology bar on the top floor. This first of its kind immersive store experience outside the Roastery of Shanghai is actually a tribute of our relationship with the Beijing community where we started in China nearly 20 years ago.

Now the growth story Beijing is not a one-off. In fact, it only highlights our intentionality to create the regional and city center to bring this Starbucks Experience alive, region after region, from the east to the west and city after city from Beijing to Shanghai and from Guangzhou to Chengdu. Now everyone, what I just took you through is a firm demonstration how Starbucks China has been able to create, to test, to launch, and importantly, to lend the next-generation of innovations and creations to fit our ever-changing lifestyles and the consumer needs here in China. This is an important capability that we must have to win in this market.

Now, the 3rd place strategy is not just about our store and the beautiful space. It is also about our product experience. Our customers discovery journey actually continues across our three key beverage platforms, the core, the coffee forward and the seasonal offerings. The cafe latte, the cappuccino, the Frappuccino and other Starbucks core classics are all delivering significance sales in our portfolio. You have to remember, this product in a new city like Xiangyang, they define the first taste of our customers with Starbucks and they form the foundation to build a daily coffee ritual for the many years to come among these group of customers.

Now in the past few years, we also tailor made our menu board to facilitate easier and faster decisions, when people are in front of our bar. Over time, of course, some of the customers they will gradually shift to our coffee forward offerings when they seek to know more about coffee. Did you know that we have already rolled out our cold form in all our 3,300 stores in China? Now, within the past 18 months, we also introduced Nitro Cold Brew in nearly 400 stores. Also in the past nine months, we have introduced our [ph] Avogadro (01:03:27) platform in 260 stores in the market. We are so excited to see this coffee forward platform, leading our growth with 59% CAGR over the past four years.

Now of course you are in China, we have to talk about tea, right? Everyone, you are in the tea nation where tea is significantly larger than coffee. We have introduced Teavana with a creative interpretation of the Chinese tea culture and element in 2016. Our re-imagined tea innovations posed an exceptional 40% CAGR growth in the past four years. I really cannot wait to have you visit our Teavana bar later tonight. You'll be excited to see it has far exceeded our expectation. And the reason is simple because we're creating familiar, yet unexpected experiences on tea, when people are in front of the bar, it is unique and very premium.

Our seasonal beverage offerings are also helping us to create new occasions in our stores, as our customers love all kinds of celebration, holiday and festivals. Our China R&D and marketing team has created relevant beverages for the modern celebrations. For example, the Singles Day on November 11th, I think you all know. And you probably also know that upcoming May 20th, The China's Days of Love, because in Chinese, Wǒ ài nǐ, I love you. And all these innovations and products are created to really attract and delight our millennial customers.

This again demonstrates our ability to remain agile and be locally relevant, and importantly, to response richly to the ever-changing consumer needs. And we have taken a complementary approach with our foot innovations to elevate across dayparts and develop a new consumer behavior. For our strongest afternoon daypart, we are constantly evolving and innovating on our iconic cake series as a coffee treat for the aspirational middle class,

and of course, we are also innovating to pure morning and lunch daypart with unique food offerings for every occasion.

The food options like a proven U.S. breakfast sandwich and bakery line as well as the newly introduced Greek yogurt series are the refreshments of the latest consumer taste preferences. And for holidays, I mean autumn festival in September, and Dragon Boat festival in May, we also create modern interpretations of this 1,000 year festival and occasions and also give solutions to the middle class and the millennial. For example, our mooncake retail up for almost \$100. It's highly sought after, a premium and exclusive gift when people are looking for something to express to their loved ones, and this is why our mooncake has exceeded 30% CAGR growth in the past two years.

Now, everything that we do from the store design to our innovative beverage offerings to the gift occasions and options has holistically elevated the Starbucks Experience. They build on each other to truly deliver a premium experience within the 3rd place. And this is the reason why the 3rd place remains the most preferred gathering point and has resonated so well with the modern Chinese customers. That said the beautiful store and the innovative product are only part of the story. Our partners' passion to perfect the coffee craft is the real key for the success of our brand. The craftsmanship is actually embedded in the 1,000 years history of China, as you all know. This comes to life in our store when pairs of customer serve as [indiscernible] (01:08:54) the Chinese mentor and to the apprentice, just like in the movie Kung Fu Panda.

So by joining this traditional bond and together in the store, a culture of family is formed in each and every store we operate. This culture is amplified by the retail and coffee education program available through our Starbucks China University. As our partner gain deeper understanding of the bean-to-cup journey, it graduates to the next stages from our core store to brew bar to Reserve bar and to flagship and finally to the highest level of coffee craft, the Shanghai Roastery.

Now in closing I'm so excited with our 3rd place strategy under the purpose-driven China growth agenda. We are the undisputed leader to bring the Starbucks 3rd place experiences alive. In a way that we step in, the deep respect of our culture here in China and also responsive for the ever-changing needs. I know this is only the beginning and I cannot describe to you the enormous opportunity ahead of us when coffee become a daily ritual here in this market. Thank you, everyone.

And with this I'll hand you to Emily, our CMO, one of the smartest persons I have worked with. She is going to tell you how we are going to merge digital in 3rd place and redefine new retail.

Emily Chang

Senior Vice President and Chief Marketing Officer, Starbucks China, Starbucks Corp.

Thank you, Leo. It's so inspiring to see these images of the 3rd place and we know that because of digital, our customers' engagement with our brand begins before they ever set foot into the store. It extends into the store experience and continues even after they leave and this is what we call the 4th place. It's really one of the biggest reasons I joined Starbucks about a year ago. Good morning. I'm Emily Chang, and a quick self-introduction. I started my career with 11 years at Procter & Gamble where I immersed in brand management and consumer insights. Then, I was really excited to move to Asia where I led Apple Retail Marketing for the Asia Pacific region. And in the last four years, I've been able to serve as the Chief Commercial Office for IHG looking after portfolio of seven brands and really focusing on that digital engagement. So, with the collective ten years working in China, I thought I'd start off today by sharing a little bit about the digital landscape here.

You've all heard that China is different. And I guess let's try and talk a little bit about what's different. Let's start with a practical. For instance, you guys have YouTube and we've got Youku. You've got Google and we've got Baidu. You've got Amazon and we've got Taobao. Essentially everything digital in China roles out to three Internet giants we refer to as BAT; Baidu, Alibaba and Tencent. So what's the meaning behind the fact that we're in a pretty integrated space here. Let's look at an example. WeChat, for instance, the social platform on Tencent. With one app, I'm able to access all the functionality of the suite of apps in the U.S. So just you can imagine the convenience of going to one place and having everything you need in that ecosystem.

In addition to this integration, we're essentially a non-cash community. What does that mean? When I go out for my run on Saturday morning with my mobile device, I've got my running map, I've got my health monitor, I've got my music, my e-book, and my wallet if I want to stop for a cold brew on the way home.

On the other hand, Packaged Facts shares that 79% of American consumers are still making monthly cash payments. So that's a pretty material difference. And we're seeing non-cash, delivery is ubiquitous here and it's part of our everyday experience. So we order our food, both prepared and fresh. We order our personal care. With the tap of an app, I can have my masseuse meet me at 9:00 tonight at my door and I'm thinking that sounds like a great idea. We can order anything. Our family actually ordered our pet Bunny Mochi on Taobao and she was delivered to our home. So this is a little bit about what it's like to live in the China digital ecosystem. We call it OMO, online merges with offline. In the states you might have heard the phrase O2O, which is online to offline or offline to online, the reason China's blown by an O2O model is the two implies you're starting in one place and then moving to another, but actually it's a fully integrated experience, right. If you're online, you're already looking for offline stores. If you're in the store offline, you're searching online for social commentary on what you might be considering to buy.

And frankly, if we're not delivering an OMO experience, we're not meeting our consumers' needs. Here's another buzzword, coined by our partners at Alibaba new retail. Denial Dong, Group CEO calls it the harmonious integration of online and offline. Again, this is digital marketing meets e-commerce, meets traditional retail bundled together to innovate new brand experiences. So why does OMO and new retail resonate so well here in China? Our consumers are truly digital natives. Here're couple of statistics to bring that to life. For instance, 29% of Chinese consumers, their purchases are influenced by social compared to globally, 13%. 41% of Chinese consumers received their promotions via social compared to 34%. And here is a big one, absolutely true. My husband's one of these people. 52% of consumers shop daily or weekly on their mobile phone.

My next-door neighbor receives 10 to 15 packages a day compared to globally 14%. So as you can see, there're some pretty big differences from the integration of platforms to being essentially a non-cash community to looking at the lives and the behaviors of digital natives. Let's transition now from the digital landscape to the Starbucks digital flywheel and let's start with loyalty because this is all about the power of our brand.

Chinese customers love Starbucks. They love it. When they're carrying a cup, it's like a badge of honor. And when they walk through the doors of our store, there's a feeling that they've made it. This is an incredible privilege for us and a deep responsibility. You may know as well that the My Starbucks Reward loyalty program in China is different than in the States. It's a paid membership here. And nearly 7 million customers are actively engaged with us, paying to become a part of our community. This is a really strong connection. And it often starts in store between the barista and the consumer. It's a really meaningful relationship that sometimes runs very deep, but in the last four years, our membership has actually tripled. This is a really fast growth rate and it's continuing on because for us this isn't about buying one-time trial. This is true loyalty. It's about human connection. And it doesn't end there.

We take that relationship in the store and we extend it into the 4th place. We engage our consumers, our customers and our valued members with personal and delightful content. Did you know that 90% of active app users are using our app. Loyalty members are using our app. So how do we get to this level of engagement where we have these 90-day loyal members, they're actively engaged with our app? Well, let's go back to OMO, online merges with offline.

Like in the U.S., Chinese loyalty members can receive benefits like a free birthday drink and stars with every purchase. In addition, we bring it into the store. So we have an annual members night where we invite 5,000 of our most loyal members to about 150 of our select stores and we recognize and we reward them. We celebrate with them. So they check in digitally and often you'll see like this customer here, she immediately shares, guess where I am tonight!

They enjoy the sense of community. It's not just online. It's real. It's offline. It's with our baristas, coffee tastings as well as with each other. This is about community and connectedness. And it's not just this loyalty event because we also have an annual coffee festival that extends across all 3,200 stores. Last autumn we had over 50,000 customers join us in coffee tastings all over the region, and this really comes back to our core purpose of being. Starbucks is a different kind of company. We celebrate individual customer needs, and the customer always comes first. You might have heard this statistic that in China we have about a quarter of the stores of the U.S. and about half the active members and growing.

Again, this tells me that our brand is strong and engaged and beloved. And it's my amazing job to strengthen and nurture these shared moments of genuine connection, because Starbucks is an experiential brand. We spent nearly 20 years in China creating these moments of connections in our coffeehouses. And in the 4th place we can build on that trust to go further. You've probably have heard of our social gifting program Say It with Starbucks. It's a program we co-created it with Tencent, but it's about so much more than gifting because if the 3rd place Leo talked about is about curated stories and experiences with our partners, the 4th place enables a different sort of community, storytelling, discovery and experience. With Say It with Starbucks, we come back to our core purpose creating moments everywhere we are.

You see in Chinese culture there's a bit of an inhibition and sometimes we struggle to share our innermost feelings. Let me bring this to life as a Chinese-American. Here's my schizophrenia side. As an American if I call my mom, I would call her and say, hey mom, how are you doing. I haven't talked to you in so long. I love you and I miss you. And a Chinese daughter would have the same heartfelt emotion right, but she would express it differently. She would say mom, it's getting cold out. Are you warm? I just went and bought you some long underwear. How do we help our consumers express their deepest emotions and when is it most relevant?

Well, Chinese New Year is not only the largest human migration in the world. It's also the most emotional holiday we have in China. It's when we all go home and see our families. This year over Chinese New Year Say it with Starbucks reached out to our customers and we asked them, what do you most wish you could say to your parents when you see them this year, but you're afraid you're not going to be able to? What do you most anticipate about going home and what do you most dread. And again, because we have such an engaged customer community, we've received over 200,000 feedbacks overnight. We collected that feedback and shared it back out in the form of an info-graphic and we shared some interesting facts with our community.

For instance, did you know that more than half of you guys have shouted to a celebrity, I love you, but only 18% of you have told your mom and dad you love them. You told us that the number one thing you wish you could tell your parents this Chinese New Year is, mom and dad I know everything you've sacrificed for me. This is

incredibly deep. And what an opportunity for us to help our consumers express something that's really important to express.

So we're really inspired by this. We took the most desired messages and we turned them into digital gift cards. The best-selling gift card is this one right here. I understand all that you've sacrificed for me. We have some cute ones as well, like, yes mom, you're always right. And some other just really cute and meaningful messages that we were able to help our customers say for the first time to their loved ones, to Say it with Starbucks. This social gifting platform, it's so powerful. It enables shared connections and two-way conversations and this ties back to our corporate business Starbucks. It's just so powerful and humbling to be able to use this kind of scale for good, and it brings customers into our digital flywheel.

See when I send you, a Say it with Starbucks, you may or may not be a Starbucks customer, but you're going to go into our store to redeem and enjoy your gift. And what I love about this is, when you do, you'll meet our passionate baristas, and you deepen that connection with the brand. And I'm delighted to share that the Say it with Starbucks social gifting is now available also on the Alibaba platform. So whether you use Tencent or Alibaba, our customers are now all able to Say it with Starbucks.

Okay. So sometimes you see a photo like this one and it's a robotic arm, and it's called digital. I'd like to pause here and say, I don't see this as digital enablement because to me what matters to me in terms of digital is something that enables a deeper and more meaningful human connection. So what digital enablement enables more human connection? It may not look sexy like a robot arm, but what's sexy to me is digital payments. As you've heard, we're over 60% digital tender between WeChat Pay and Alipay. And when you look at all of our payment types in the store, we're over 80% cash free. This is an incredible benefit, because I know what my customers are buying and I know their preferred payment types. It's a great opportunity to send customized and tailored messages that better delight.

It extends beyond the benefit with the customers as well to our partners. Did you know that on average in a store, our partners spend 7.5 hours processing cash? In one month now we're freeing up 30 hours per store to further engage with our customers, to deepen that human connection and to perfect our coffee craft. To me, this is the point of digital enablement. It's not about a robot arm or driverless coffee, it's about purpose-driven innovation. It's smartly and creatively leveraging digital to tell stories, to engage customers, and to share our coffee craft. Speaking of coffee craft, you've heard of the Roastery, and you have probably heard of the AR experience we've created. I'm excited to share it with you later today. And did you know that we've already extended our AR experience to all of our core stores?

Again, speaking of Chinese New Year, this is the Year of the Dog, super cute year, very close to my heart. And we knew that over Chinese New Year this market would be overrun with dogs and we asked ourselves, how do we extend a warm genuine Chinese New Year greeting to our customers as only Starbucks can? So once again, we partnered with Alibaba and we created this fun experience where customer walks up to the store they scan the siren and one of 12 Chinese New Year greetings pops out at them through AR and they receive a digital red envelope. In Chinese it's called hóngbāo and it's the customary gift we give each other over Chinese New Year. The digital cash in the red envelope immediately slots into the customer's digital wallet. This is how it looks when you actually walk through the store.

[Video Presentation] (01:26:17 to 01:26:35)

And we've really only just begun. You know, just over the Chinese New Year period, that was scanned 8 million times. There's so much more that we can do with AR in-store digital experience. With digital payment, we're

creating seamless more convenient experiences. Social gifting is enabling those two-way conversations and that connection that we talked about and as we talked about as well, digital payment. Loyalty is starting to really bring the entire digital flywheel to life.

Do you know that even some of our coffee machines in stores are IoT-enabled. Imagine the online merging with offline experience that we can unlock. Can you tell that I'm excited to be here, I love my job? And as Belinda said, it's absolutely true. We have to earn this right to be here every day. We have to earn our customers' trust and I believe that every disruptive elevated experience we create has to be thoughtfully crafted. I can't tell you how excited I am. I've been asked to lead our delivery experience. And this is going to meet our Starbucks mission of inspiring and nurturing the human spirit. One person, one cup and one neighborhood at a time, might I add, wherever you are.

It's about uncompromising quality with the product. So wherever you are, it tastes just like the baristas just handed it to you over the counter. And though I've just been here about a year, I'll tell you I've spent hours riding on the backs of the scooters with delivery riders. We've ordered hundreds of packages and products. We want to understand end-to-end experience. Where is the point of potential delay and client disappointment? And I can't wait to share more with you on this soon because I believe our meticulous approach to this really important element of a digital customer experience is going to be delightful, authentic and only Starbucks.

So let's wrap up the 4th place. It's about how we strengthen and deepen connection with our partners, our customers and our communities. Our stores are beautiful and it's about more than the number of stores we open. Digitally, it's about more than the number of clicks and taps and impressions because it's about the quality of each and every relationship. Authenticity and trust that our customers have with our brand and to me that is our new retail. Thank you.

John?

John Culver

Group President - International and Channel Development, Starbucks Corp.

All right everyone. That concludes the first half of our presentations. So we're going to take about a 20-minute break right here. So everybody get up, we'll stretch, we'll have some refresh sampling of food and beverage for you and we'll be back to start the second half at 10:00 AM. All right. So to kick off the second part of our day here, it is my pleasure to introduce David Hanson, Vice President of China, Asia-Pacific Channel Development.

David Hanson

Asia Vice President and China GM, Starbucks Corp.

So good morning. I'm David Hanson and I have the pleasure of leading the Channel Development business for China and the Asia-Pacific region. For the past three years, I've been continually humbled by the way our Chinese consumers welcome and love the Starbucks brand. Each day, Channel Development works to extend the Starbucks Experience beyond our retail stores that Leo and Emily work so hard to create. Channel Development is poised to bring new customers to our retail stores by introducing them to the brand where our stores and locations don't exist today.

I've lived and worked in China for almost 10 years now, previously working for Procter & Gamble and now Starbucks. I joined Starbucks in 2010 during the early days of Channel Development. I moved back to Shanghai in 2015 to lead our Channel Development business. And today, we have the opportunity to lead the rapidly expanding ready-to-drink market with tailor-made beverages for China, in China. Now you've heard many

interesting insights about the rising middle class and their aspirational lifestyles that does represent a tremendous growth opportunity.

Let's take a moment and consider what this means through the lens of the ready-to-drink coffee and tea business. While the China RTD coffee category is worth about \$1.2 billion annually and showing double-digit growth, it's still just a fraction of the size of Japan and half the size of the U.S. Our consumers primarily drink coffee in the afternoon, but today's millennials are busier than ever. Some of these consumers have actually started drinking coffee immediately after they leave home on their way to the office or at the office, plus drinking coffee throughout the day. Disposable income is also on the rise.

Chinese consumers born before 1995 spend far more money on travel, entertainment, and shopping. Starbucks RTD aligns to these on-the-go occasions, and is becoming even more convenient than ever to find our products. In fact, the emerging convenience store channel now has over 50,000 stores with new stores opening literally every hour, you'll find them in literally every apartment building or office as you travel.

E-commerce is another emerging opportunity. It's becoming a major shopping habit of choice and making shopping convenient no matter where you are. So to better understand the Chinese millennial and our opportunity, let's zoom in on the day of a life of one of our consumers.

Let's talk about Tiffany. Tiffany is a 28-year-old Digital Marketing Manager working right here in Shanghai for a multinational company. Tiffany is like many other Chinese professionals. She works incredibly hard at her job, she earns a reasonable income, in fact she earns almost twice as much as she would've earned just 10 years ago. Her typical day, she starts on the metro, she's drinking one of our new Starbucks Doubleshots and she's skimming the news on her iPhone as she heads into the office where she's ready to take on the day.

This gives her an early start to the day and besides there isn't a Starbucks store in her office. Well, not yet, it's coming. But because of her busy lifestyle, she's that new generation that's drinking coffee before starting the work. After her morning meetings, she'll break for lunch at exactly 12 o'clock with her co-workers. On the way back from lunch, she'll stop at a newly opened convenience store in her building and buy herself an afternoon pick-me-up. She'll pay for that using Alipay on her phone as she does for almost all of her purchases.

Later that weekend, her and her friends decide to celebrate their hard work and may go to see a movie at a new premium movie cinema. They head out shopping after the movie and they stop by their favorite Starbucks Store for a celebratory Peach Blossom Tea Latte. Tiffany's journey will offer Starbucks more and more opportunities for us to interact with her lifestyle. And they'll be more and more Tiffany's in the marketplace.

So we're challenging ourselves to create new beverages in new locations in China, for China. And with the support of our local strategic partner, Tingyi, China's largest beverage manufacturer and distributor were already addressing key opportunities.

So let me start to introduce our ready-to-drink lineup starting with Bottled Frappuccino. Similar to our approach we take with retail, we sat down with RTD consumers to understand their beverage taste preferences and occasion trends. This local insight combined with our China dedicated research and development team led us to introducing six tailor-made flavors, including Starbucks signature coffee and two entirely new to the world tea blends.

Matcha green tea and black tea Frappuccino already represent over 20% of our Frappuccino business. We've already heard this is a tea-centric culture and so our opportunity for growth in this area is plenty. Consumers love

the taste and they love the iconic bottle. In fact, they are reusing that bottle for arts and crafts and in-home decoration. Since the launch of Bottled Frappuccino, we've already placed Frappuccino in over 50,000 places of distribution. We have access to distribution in over 200 cities and we're making it easy for consumers like Tiffany to find our products throughout the day. In less than two years, we've delighted our on-the-go consumer with over 40 million servings.

And although we're still a relatively small player in China, we've already tripled our market share and we're the leading coffee brand. For perspective, it took us almost five years to achieve the same sales and market share status in Japan. With Tingyi's local expertise, we have access to China's elevated premium specialty channels; cinemas, high-speed trains, five star hotels, and, of course, your favorite premium grocery and convenience stores.

The success of Frappuccino led us to the recently launched tailor-made Doubleshot and when I say recently, I mean, just four weeks ago, we launched Doubleshot as the preferred energy boost to fuel today's busy lifestyle of our millennial. Starbucks Doubleshot was launched in four China exclusive packaging with four tailor-made flavors. It's convenient grab-and-go single serve size makes it easy to be distributed across China even as we speak today. These initial flavors are just the beginning. Our China R&D team has a full range of plans to launch new concepts and formulations for future release.

But the opportunity doesn't end here. In fact, I'm proud to announce for the very first time the launch of Starbucks chilled cup arriving on shelves June 12th. Our new chilled cup is a premium coffee and tea refreshment and our retail inspired cup. You can enjoy it at-home, on-the-go, or right now. Now I apologize to those of you on the webcast, but you'll have to wait till June 12th and enjoy it in one of your favorite stores. But please enjoy, I put a few tasty notes here [indiscernible] (01:37:32) way you go to enjoy our newest refreshment. I hope you enjoy this as much as I do.

Our new cup combines the most refreshing dairy and Starbucks signature coffee to bring consumers the creamy latte experience with every sip. Chilled cup has been incredibly successful in Korea and Japan and continues to grow. And we know with the retail connection of this brand, this will be a huge success here in China.

So considering what we've launched in a relatively short period of time, the future innovation plans that we have, we expect our ready-to-drink business to dramatically grow in the next five years. We expect to move from our current 50,000 points of distribution to 125,000 points of distribution. We'll move to being available in around 200 cities to being available over 400 cities across China. And we expect to grow from 40 million servings that we've served to-date to serving over 200 million servings annually. This is an increase of more than five times our current business and we'll clearly establish Starbucks as one of the largest beverage companies in coffee by 2023. This means Channel Development will clearly extend the Starbucks Experience well beyond our retail stores and be a complement to our Starbucks retail stores.

But this is only within ready-to-drink. We now have a new opportunity through our recently announced strategic alliance with Nestlé to capitalize on the white space we haven't even touched today in the areas of single serve, at-home coffee and premium foodservice. As Kevin shared, this alliance opens the door to accelerate our pace to enter the single-serve space at Nestlé's established machine platforms, whether it's Nespresso or Dolce Gusto. It also elevates our at-home coffee experience by leveraging Nestlé's vast reach and scale through their current business with convenience stores, grocery stores and other established channels.

Importantly, it addresses our significant white space opportunity in foodservice giving us access to premium, offices and five star hotels across China. So we're confident of the Channel Development opportunity especially

when you consider; first, we have a strong Starbucks brand in China; second, we have the right local and global strategic partners to help us win; and third, we have a growing consumer base, that's discovering how coffee fits into their aspirational lifestyle. The in China, for China Channel Development opportunity is immense, and I promise you we're ready to win in China. Thank you.

Now I appreciate your patience because I know you've been waiting for the financial reports and analysts. So without further ado, please I'd like to welcome Weiwei Chen, our CFO.

Weiwei Chen

Vice President and Chief Financial Officer, Starbucks China, Starbucks Corp.

Thank you, David. Thank you. Good morning. Welcome to Shanghai. Welcome to my hometown. I'm Weiwei Chen, China's CFO. I was born and raised in Shanghai and have been working here for past 19 years. I am a three-year partner. Prior to Starbucks, I was with Yum! China, where I learned a lot about retail from a strong China QSR operator. I joined Starbucks for the love of the brand that I have been the loyal customer for 25 years. I joined the company also for my career goal of being part of the fast growing business. The past three years has been a very rewarding and fulfilling journey for me. The numbers on the next slides you'll see are the best testament. I am extremely proud to be part of the team that contributed to this outstanding performance.

What I'd like to highlight today is that our success is not only attributable to our scale, to our ability to scale and innovate, but also a direct result of our disciplined growth approach. [indiscernible] (01:42:03) 20 years, we have been practicing our Kung Fu as we grow, learn to find the right real estate, recruit and train the right people to open stores, build relationships with the local government and community. We repeat the same for each new store we build and each new market we enter.

We have in place stringent investment approval, monitoring and reporting processes and cross-functional collaboration mechanism to address any performance issues. As a result of this, I see many of you are taking photos. As a result of this very disciplined approach, our business is in a very healthy state.

We have had tremendous growth on both top and bottom-line over the past four years. The biggest driver behind such growth is our store development, which grew from 1,000 stores back in FY 2013 to close to 3,300 today. We also achieved fantastic comp growth. China comps have stood in the mid-single digits for the past 34 consecutive quarters. We are in people business serving coffee and continuing to elevate our partner experience is the most important investment we make.

As you can see here in the top two charts, turnover in our retail and support center partners is much lower compared to industry average. This is one of the reasons behind Starbucks China being awarded Employer of Choice multiple years. This also means that our investment helps to retain a very stable workforce enabling us to deepen the partner and customer connection.

At the same time, the benefit of low turnover helps to improve our labor productivity and efficiency when coupled with the scaled growth. The bottom two charts as you can see here show averages store head count and IPLH both improved double-digits, respectively, in spite of our [indiscernible] (01:44:22) which required us to have partners hired, trained and in-place to offer new stores.

As I mentioned earlier, our China growth is largely driven by store development and it will continuously to be so in the foreseeable future. Over the past five years, our overall store cash profitability significantly improved by more than 800 basis points to 39%. This kind of result can only be achieved through a very disciplined approach. Looking at first year new store cash profitability and ROI, you guys have to agree with me they are best-in-class

performances. Not to mention that these numbers were achieved while we accelerated our new store development pace.

In addition, you can see that our first – our new stores in top tier cities continue to generate very healthy returns, while lower tier cities benefit from better labor and rental structure are generating even more impressive results. I can't stress enough how hard our retail partners worked to achieve this kind of returns, particularly when they have to leave their families to open new markets. These economics give us the confidence and credibility to continue to execute our store development strategy, go wide, go deep.

As you just heard, we're going to accelerate our store development pace by 20% from 500 new stores each year to 600. We look forward to enter into 100 new cities in the coming five years where we can bring our Starbucks Experience to even more Chinese customers.

Now let me talk about our largest category, beverage, which accounts for more than 70% of our sales mix. Over the past four years, we have seen this category growing at a CAGR over 30%. While our core and our seasonal mix are growing very strong, what I would like to highlight is brewed coffee and tea categories. Those still small in mix but have been our biggest growth drivers. The growth of our brewed coffee category has been the result of our intentional coffee-forward strategy. Today, almost a third of our portfolio is coffee-forward stores. The AUVs for these stores on average 20% higher for the same age class and have on par profitability compared to same age Pasco stores.

Despite higher investments for the elevated customer experience, our coffee-forward strategy is working in China. We want to continue investing in this strategy. The launch of our Teavana Iced Shaken Tea platform over the past couple of years has helped to drive the growth of our tea category. Our Chinese customers love this new innovation, which combines our core iced tea with unique freshly steak foods that is useful, refreshing and relevant to their taste. I encourage all of you to really try this new innovation while you're here.

In addition, tea is actually a strong brand [ph] recruiter (01:48:07). About 17% of our new customers' first Starbucks purchase is a tea beverage as tea is an approachable, welcoming beverage to the Chinese customer. We see Teavana as a viable platform to grow our brand appeal and the Roastery Teavana innovation gives us great confidence to continue to grow this category.

Let me now turn to some of the growth opportunities that we're working on which will deliver very exciting results for us. Let's talk about dayparts. Chinese dayparts are quite evenly spread throughout the day. This is actually a unique advantage in terms of asset utilization. Unlike the U.S. dayparts where morning is 50% of the mix, we have the ability to better deploy labor throughout the day. We can also avoid investing in extra store equipment that are required to beat peak hour capacity needs. We have seen an emerging, faster morning daypart growth as our customers are developing their morning coffee ritual.

To expand this daypart, we're building more stores closer to offices and residential communities that can bring morning convenience to our customers. In addition, we're increasing food offerings that specifically target to this daypart. Our bakery products and Greek yogurt cups are big hits. Today, we see a much higher morning daypart mix for top tier cities due to more devolved morning coffee ritual and higher Starbucks store base. We believe that the morning daypart mix will continue to grow while we expand into lower tier cities as consumption behavior catches up to top tiers over time.

Let's talk about East China. East China by far is Starbucks' largest investment. The East China integration will allow us to scale faster and helps to prioritize investments holistically across China. Let me highlight a few areas

of opportunities for you. We see opportunity in leverage the East China talent pool that has strong operational expertise we can deploy at national level to accelerate our growth. We can also leverage our branded Starbucks China University training and development programs to benefit the entire 45,000 partner population.

Furthermore, we see synergy in partner investment programs that enable us to make [ph] holistic (01:50:49) decisions at national level to continue elevate our partner experience. We see synergy in supply chain as a result of combined scale or sourcing. We can drive upstream commodity management in terms of price competitiveness and quality management.

To give you an example, today two-thirds of an East China procurement base has different suppliers. We see opportunity to integrate the two supplier bases over time, which can give us significant cost advantage. Through more synergistic supplier management, we can also execute better on a food safety [ph] go (01:51:29) standards to deliver a consistent brand experience.

Our logistic network, we see synergy introducing competition through logistic provider selection and more optimized planning for distribution centers and delivery routes. As we advance our China digital flywheel, we can leverage the combined market to seamless deploy programs like delivery, MOP and MSR personalization. We see opportunities speak to market, now that we no longer have to rely and negotiate with the former JV partner.

Furthermore, we see opportunity in cost efficiency as there is no longer a need to duplicate investments in two markets. For marketing, we can move from two seasonal campaigns to one. We can move from two official websites to one integrated site with better presentation and cost efficiency. For market insight, we can reduce redundancies in analysis, consumer research and reporting. We see opportunity to integrate two food programs leveraging Starbucks R&D capability. We believe our China R&D lab's new innovation can benefit East China market to provide our customers with relevant and consistent food offerings.

As a matter of fact, the East China market has a larger morning and a lunch daypart compared to rest of China. This gives us opportunity to bring breakfast and lunch programs to the East China market to fully leverage and grow these two dayparts.

I'm certain there's more out there for us to uncover as we go deeper over time. In a nutshell, the East China integration will enable faster decision making, faster execution of roll-out, better cost efficiency where we have a unified market. With all the China growth strategies my peers highlighted earlier, we see immense growth opportunity for East China.

Again, we're only five months into East China integration, there's much more learning ahead of us. I'm happy to report that the first five months' business is stable, so is the East China organization. The China team is committed to make this integration a success.

In conclusion, we see tremendous growth opportunities ahead of us. We will continue our strong store development strategy to further penetrate in key markets and expand into lower tiers. We will continue to work hard on a third place, digital and out-of-home innovations to delight our Chinese customers and drive growth, at the same time applying our disciplined growth approach in all investments and execution to take us to the next level.

On the basis of FY 2017 actuals, which includes East China as a joint venture, we expect – this should be on next slide – we expect China's revenue to move from – to more than triple and operating income to more than double by the end of FY 2022. This is a very exciting time for China. The China team is both energized and

committed to deliver these growth targets and I am eager and proud to continue elevate this team through this historical growth in China.

Now let me introduce, John Culver, our Group President, International Channel Development to you talk to about building an enduring company in China. Thank you very much.

John Culver

Group President - International and Channel Development, Starbucks Corp.

Good morning, everybody. And first off, I just want to take this opportunity to welcome all of you to Shanghai in our first ever Investor Day in this market. I would like to remind you that not only are you in China, but also in Shanghai where we have more stores than any other Starbucks city around the world. And it's just the beginning of what is going to be the largest market for Starbucks that we operate anywhere in the world.

You know I hope that over the course of this morning you've gotten a sense for the type of company that we're building and the type of business that we've been able to build over the last 20 years. And more importantly, the tremendous work that the team has done here over the last five years to really accelerate the growth, to do it in the right way and to really bring to life through our partners this love, this passion, this sense of family and this sense of belonging that has made Starbucks one of the most admired and respected companies doing business in China today, whether it's a Chinese company or whether it's a multinational company, it's something that we are very, very, very proud of, and it's something that we take very seriously.

I also hope that you walk away not only from this morning, but more importantly as you go through your day-to-day as well as tomorrow, this sense of the opportunity that we have for Starbucks' growth in China. We've outlined for you and you'll get a strong sense as to why we believe Starbucks has decades of growth ahead of us here in this strategic market. I also hope that you understand that the team that Belinda and the leadership team has assembled here, is world-class unlike any other leadership team that exists for any retailer doing business in China.

It's their depth of experience, it's the knowledge of the Chinese customers, it's their unwavering commitment to each other, and, more importantly, the way in which they've been able to elevate the 45,000 partners and build that passion and pride in creating a great Starbucks Experience for our customers each and every day. It is built on the mission and values that have made Starbucks a great company and it is something that is at the core of our success and will continue to be at the core of our success here.

I have no doubt in my mind that China will continue to lead the way for Starbucks as the fastest growing market with an unprecedented growth opportunity where we will have tens of thousands of stores one day and we will definitely be the leader for Starbucks globally.

Now before I take the opportunity and go into the Q&A with everybody, I know you probably have a lot of questions. I wanted to take this opportunity to take a step back and to zoom out a little bit, so that you can understand how the immense China opportunity fits into the bigger construct of the CAP region as you know it. So the CAP region consists of China, it consists of Japan and there are 14 other markets that we operate across this region. Three of the top five largest markets for Starbucks sit in this part of the world, in terms of store count, in terms of revenue, in terms of operating income and in fact CAP, the segment represents our highest margin segment we operate in the company outside of Channel Development and we're just getting started.

Across the region we have 122,000 partners to serve 21 million customers a week. We have over 8,000 stores. And as you've seen through our performance, these stores in these markets perform very, very, very well. And if

you look at the overall growth rate across CAP in the most recent quarter, we grew revenues an astounding 54%. When you take and you normalize for FX and you normalize for equity adjustments, we actually grew 13% leading the way for the company.

More importantly, two years ago, we outlined for you growth targets that we would achieve by 2021. In December of 2016, we talked about our ability and belief in CAP that we would deliver what we call a triple double, two times revenue growth, two times store count growth and more than two times growth in our operating income across these markets. We are well on our way to achieving those goals and we will update those goals in December when we are together in New York.

Now as you look across the region, there are 3.5 billion people that live in this part of the world, 30% are under the age of 29 and the GDP growth in this part of the world is an astounding 5%. Really the themes that you'll see are really in three key areas: first, the increasing growth of consumer spending; the rising middle class; the rapid urbanization that is taking place and the strong sustained economic growth that is expected for the foreseeable future.

There are going to be millions of new consumers, who are going to add trillions in spending power over the next few years in this part of the world. And as their aspirational lifestyles expose them to new brands, to new experiences, many of them will be coming to Starbucks for their very first cup of coffee. The strong growth, the momentum across the region is going to drive the future growth for Starbucks as a company around the world.

Now let me drill in to a few of the markets in particular that I'd like to share with you. And let's first talk about Asia Pacific. Okay. Asia Pacific consists of 14 markets, from Singapore where we opened our first store in 1996 to our newest market Cambodia which we opened in 2016. Across Asia Pacific, we operate 3,400 stores and we have over 40,000 partners. A key statistic here is we are opening a store each and every day in Asia Pacific and our stores similar to what we're doing in China are pushing boundaries in terms of the design, in terms of the coffee and beverage innovation, and, more importantly, in terms of the partner experience and the customer connection.

Moving to South Korea; South Korea, we opened our very first store in 1999 through a joint venture partnership with Shinsegae Group. Not many people know, but South Korea is our fifth largest market today. We're approaching 1,200 stores and our system sales exceed well over \$1 billion. What's really great about Korea is the digital experience that they have been able to create and, in particular, they were the first market to introduce Siren Order, which is actually the first evolution of Mobile Order & Pay as well as Starbucks Rewards in this part of the world.

Today in Korea, we have over 4 million My Starbucks Rewards members and we are increasing membership 30% a year – on a year-on-year basis. Last month, we introduced voice ordering in Korea and the initial reaction from our customers from the market overall has been far above the expectations that we had.

Now another market that not many people pay attention to is Indonesia and we see a tremendous opportunity for growth in Indonesia. We have 330 stores, GDP in Indonesia is expected to grow 5% this year and the overall population is 270 million – expected to be 270 million by 2021 and that represents about 13% of the total Asia Pacific population. Indonesia is an opportunity for us to continue to accelerate our growth.

Let's go to India. India, as many of you know, has demonstrated very strong GDP growth from 5% to 8% historically and projected to do that over the next several years. India, 1.4 billion people. We've now been in this market for five years. We have over 110 stores and we just opened our seventh market in city in India. Similar to China, where we've been here now for 20 years, we are taking a very long-term view on India and we believe that

if we can continue to focus on building our brand the right way, building the connection with our customers and our partners the right way, that one day India will be one of the top five largest markets for Starbucks that we operate in the world. I have no doubt.

Now, let's talk about Japan. Starbucks Japan was the very first international market outside of North America. This year, we celebrate 22 years in Japan and we operate more than 1,300 stores across all the prefectures in Japan. In Japan, we're focused on continuing to expand our store footprint. We've now accelerated the growth of our stores and we're opening over 100 stores a year in that market. We've elevated our core offerings and we've made investments in the digital flywheel. We've recently launched Starbucks Rewards in September, and during that time from September to the point we are now, we now have over 2.4 million Starbucks Rewards members who have entered that program, which has far exceeded the expectations. And in the most recent quarter, we delivered positive comp in Japan for the first time since 2017. Going forward, we're going to continue to focus on how can we continue to accelerate our growth in Japan while capturing share in that strategic and major market, still big opportunity in Japan.

Now, I often get asked the question by people of what has made Starbucks successful in this part of the world and what has been the secret to our success. And it's very simple. And I think you're going to see this over the course of the next two days. At the end of the day, the reason why customers continue to return to Starbucks and new customers continue to seek the Starbucks Experience is because of our people. It's our partners who deliver an unparalleled Starbucks Experience each and every day to the customers that they serve. And it's literally one cup at a time.

If you think what Leo talked about, and you talk about the brew bar, we are actually educating Chinese customers one-by-one on what high quality is, and our partners are at the center of bringing that to life and it's because of that, we've been able to create and demonstrate that Starbucks is much more than a coffee retailer, we are humanity, we are community, we are connections and we offer a daily dose of optimism in a third place where anyone and everyone is welcome.

Our transaction levels in this part of the world have never been higher and we see continued opportunity for upside. And nowhere is the Starbucks Experience alive and well more so than right here in China and you will see and experience that. Starbucks has cracked the code in China in a way that few other brands have been able to do so. But we recognize that our past success is not an entitlement and we have to continue to earn the trust, the respect, the loyalty of our customers, and the love of our partners each and every day.

Throughout the 20 years that we've been here, we have strived to build a different type of company. And I'm very proud to say to Belinda, to the leadership team, to the 45,000 partners here in China, I'm incredibly proud of what you have been able to build, the way in which you bring it to life, and, more importantly, the way in which you represent our company and represent the mission and values that we hold so dear. Thank you very much.

Now, I've also had the opportunity to work in this part of the world to lead the CAP region over the last 12 years for the company. And I can honestly say and unequivocally say that our China business has never been stronger, our aspirations have never been greater and our future here in this part of the world has never been brighter and we commit to you that we will continue to grow this business the right way, we'll commit to you that we will continue to drive the success of the business to make everybody proud, our partners, our shareholders, our customers and each other.

So thank you guys so much for being here, thank you for making the investment to travel here. This is an historic moment for our company here in China, and we're proud to have you all here to be a part of it. So, thank you.

Thank you. So with that, what we're going to do is we're going to go to Q&A. And what I'd like to do is invite the leadership team to come up and join me as well as Scott and Kevin and then we'll get into a Q&A session. All right.

QUESTION AND ANSWER SECTION

Kevin Johnson

President, Chief Executive Officer & Director, Starbucks Corp.

A

So we have two runners with the mic to run around.

David E. Tarantino

Analyst, Robert W. Baird & Co., Inc.

Q

Hi, everyone. David Tarantino from Baird. My question is about this China business. I think you shared some very impressive metrics on store level returns, but I think that was excluding East China. So I was wondering if you could maybe just directionally even talk about what the returns on the new units in East China are so that we can frame up sort of how to think about that? And then perhaps to think about 600 units a year, let's talk about how – what proportion could come from East China versus the rest of China? Thanks.

Scott Maw

Executive Vice President & Chief Financial Officer, Starbucks Corp.

A

I'll take the first part, David, and commit that when we come back in the December Investor Day, we'll give you an update of all of Mainland China, including East China store metrics. You can imagine with the integration going on, we're still getting our arms around all of the return and we know the market pretty well. But we really want to make sure that we can give you the right level of historical performance and current performance for East China. So, we'll do that in the December Investor Day. We just want to run the market for a couple more quarters. And as far as the growth opportunities, maybe I'll turn that to Belinda.

Belinda Wong

Chief Executive Officer-Starbucks China, Starbucks Corp.

A

The new stores are performing pretty well and we're continuing – I'm very pleased to say that we're on track on our new store growth this year as well, even though we're five months into the integration. So, what else do you want to add on Weiwei on that?

Weiwei Chen

Vice President and Chief Financial Officer, Starbucks China, Starbucks Corp.

A

I think the question was how would you be balancing between the two markets in terms of stores? I think we work making sure that we capture all the opportunities, executing our strategy in terms of the go wide and go deep. So, obviously, now having combined market and to take into consideration would not be separate – sort of setting separate targets rather setting targets holistically for China.

John Glass

Analyst, Morgan Stanley & Co. LLC

Q

Thanks. It's John Glass from Morgan Stanley. Two questions. What is – Scott, just a very basic one. How – what's the percentage of profits that come from China today, if you pro forma that for the acquisition? We've all done the back of the above math envelope, but I just envelope math, I just want to make sure it's right.

Secondly, when you talk about the expansion with sort of in unit growth, how do you think about tiers and cities, you know what's the current estate from Tier-1, Tier-2 to the third to fifth tiers and where is that incremental growth coming, is a pro rata or are you pushing more into lower tier markets because there's a greater opportunity to grow vis-à-vis let's say the larger tier store markets?

Scott Maw

Executive Vice President & Chief Financial Officer, Starbucks Corp.

A

Thanks, John. So I'll take the first part. We haven't broken out specific profitability of the market for China. What we've talked about is revenue growth in that 20% range, driven primarily by new stores, with operating income growth slightly higher than that, but we haven't actually given specific profitability at the country level. And as far as maybe the tier cities, Belinda, do you want to talk about that?

Belinda Wong

Chief Executive Officer-Starbucks China, Starbucks Corp.

A

Yes. Very excited about our new store target. We have had a strategy to make sure that we focus on the key markets in China and we're going to continue to do that because it's important that we continue to nurture and build the brand in the key strategic markets. And lower tier cities, as you can see, the economics are doing fantastically well for us and it's such a privilege for the part – for the customers to be – to now really waiting for Starbucks to enter the city. And we have a certain percentage of going to key markets, which is the majority and then we're not going to just go chase after store counts, we're going to do that in a very disciplined way, winning in our brand in China. So I'll let Leo to talk a little bit more about it. If you want anything to add?

Leo Tsoi

Chief Operating Officer, Starbucks China, Starbucks Corp.

A

Thank you, Belinda. Actually, Belinda was just sharing about the 100 store – 100 city-odd entry in the next five years and pretty much all of these 100 cities in the Tier-5, as we define it. So what it means is every year we're going to bring the brand into another – around 20 cities of these Tier 5 cities that we're entering into. And as Belinda just said, all these cities requires our patience and discipline to grow because it typically take a few years to really work with our customers and the market there to build the company rituals and gradually we can see the acceleration of city of that scale.

John William Ivankoe

Analyst, JPMorgan Securities LLC

Q

Hi. Thank you. It's John Ivankoe, JPMorgan. The question was on opening 600 stores a year and obviously we understand when you put in Mobile Order & Pay in the United States or some operational changes and maybe some physical changes that needed to happen in the U.S. store base and delivery is another complication, perhaps to add the store design and store operations as well. So the question is, when you do contemplate the 600 new stores a year, how much are going to be specifically optimized for Mobile Order & Pay and delivery capability? And the question is also, how easy or difficult is it to begin to retrofit some of your current estate to some of the next generation digital type of initiatives which were very clearly where the market is going?

Belinda Wong

Chief Executive Officer-Starbucks China, Starbucks Corp.

A

Great question. I have the privilege to run the market that I opened 600 stores and I only have 3,300 right now. So I can do whatever I want on the new stores. So, meaning that I am building my new stores with the space and/or already for our future innovations to make sure that we're spending our investment wisely. So in terms of the future MOP or delivery, we've already thought about that in how we could allocate the space and make sure that investment the first time is covering the basic infrastructure at the store and the service level that we needed to have.

And I think you heard us say many times today that running China is real – I can't really just describe to you how dynamic it is because we're in a 141 cities and it's like running a 141 markets. Once you enter, you have to nurture and then you have to look at each and every market and kind of balance the speed of growth and not too soon and not too slow and we have to do all that to kind of balance it. So not only the MOP and delivery, when you look at what we talked about Nitro, the [ph] Avocado (02:19:16) platform, we have new stores are being built every 15 hours, that's already thinking about that.

Jeffrey Bernstein

Analyst, Barclays Capital, Inc.

Q

Hi, there. Jeffrey Bernstein from Barclays. Two questions, maybe just one from the industry backdrop perspective being that most of us don't have our feet on the ground here and we don't necessarily have the same third-party data that perhaps we have in the states. So I was just wondering if maybe you could just frame for us just the size of the category that we're talking about, maybe the – your biggest competitors, but other than your competitors, just how quickly that maybe the category is growing in the food at-home versus food away-from-home, just some of the kind of size up the scale of the opportunity that we're going up against them within what category?

And the other question was just on government relations, which I know you mentioned one of the people you pointed to kind of work on that very closely. Just in the current environment, I was just wondering if you can provide some thoughts how are the relations, how that maybe your approach here differ from other countries, especially now we're seeing lots of U.S. political tensions. I'm just wondering how you guys think about something like that? Thank you.

Belinda Wong

Chief Executive Officer-Starbucks China, Starbucks Corp.

A

About the size of the market, man, I wish, I knew, because this every day it's growing and when I say that the coffee market in China, it's not even possible to size it up. But what we've been doing in the last 20 years have been focusing on getting the experience right in our retail stores, but as you've heard today from David, we're now entering into the white space, right, the On-the-Go, and also the Nestlé opportunity in at-home coffee. So this is entire coffee space, as more customers pick up the coffee consumption habit, and then slowly become a daily ritual. Now remember, every city, every person is going through this journey slowly. I just know and my focus right now is to be bigger than the U.S. soon.

John Culver

Group President - International and Channel Development, Starbucks Corp.

A

I would just add the context on that is the consumption. And I know we talked about this at the shareholder meeting and was highlighted again today, less than a half a cup of coffee is consumed here per day in China across the population compared to much higher levels in the U.S. So the upside – 300 in the U.S., so the upside is enormous, as we build that daily coffee habit and the daily ritual and the opportunity to really define what high quality coffee is for the Chinese consumer. And again go back to the fact that, literally we are educating customers one cup at a time, and it's amazing to go into these stores and see, and you saw it in some of the

pictures, the level of engagement of customers with their phones, taping the baristas, understanding how to make a pour over or understanding Chemex or understanding what's the difference between [ph] Canyon [02:22:24] or House Blend, right. There is a thirst and a hunger here in China with the millennial population to understand that. And I think what we've done Belinda and her team have successfully tapped into that sentiment. And our partners again have bringing this to life through their passion, their engagement and their love of coffee, and the way they express it. It is something unique and something very special.

So, on the government side, I don't know if you want to talk about that, Kevin.

Kevin Johnson

President, Chief Executive Officer & Director, Starbucks Corp.

A

Yeah. I'll take the question on the geopolitical side that you asked. I think as we've demonstrated in the discussion we've had this morning that we've been in this market for 20 years, and every step of the way we have been very thoughtful and intentional to build this business in China, for China, do it in a way that is true to our values of taking care of our partners and innovating around things like catastrophic insurance for the parents, the healthcare, the exchange programs that we do, and building trust with our partners and that then extends to our customers coming into China with great respect for the culture and the customers. And so we've built this business on – based on respect for the culture, based on trust and based on the values that our company stands for. And I believe that in continuing to build this business true to those values will be very helpful to us in the relationship that we have not only with our partners but with our customers and the government in China. You know that said, nobody is going to be immune to geopolitical issues. But I think our approach is to continue to do the right thing every step of the way and with the belief that we are here for the long-term. And if we do the right thing, that will be the best outcome in the long run. Thank you.

Karen Holthouse

Analyst, Goldman Sachs & Co. LLC

Q

Hi. Karen Holthouse from Goldman Sachs. So going back to the slide that had the five-year targets for China that had three times the revenue, but two times the operating profit. Why would operating profit be growing so much slower than revenue? And going back to the prior five-year target that had operating profit growing in line with revenue. Presumably China would have had to be close to that to be doing that at the segment level? Also, what's changed since we got those targets?

Kevin Johnson

President, Chief Executive Officer & Director, Starbucks Corp.

A

So if you go back to the Investor Day in 2016, I think we said three times revenue and two times operating profit. And so now we're saying greater than three times revenue, two times operating profit. The reason that operating profit is growing more slowly is really because of the change in the accounting and the JV network versus revenue. So when we take all of that revenue in, when we change the accounting, you get 100% of the revenue versus under the old accounting method you had some very small fraction of the revenue and 50% of the profit. So it's just the math and the accounting that the actual margin when you get into 2019 and beyond we will see margin expansion. In other words, operating profit in China will grow faster than revenue, but as you move from 2017 which was under the old JV accounting with almost no revenue to 2018 under the fully consolidated accounting with all the revenue, you just get that mathematical impact.

Jonathan Clifton Conley

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Hi. This is Jon Conley from Stifel. I was just hoping you could better characterize some of the weakness in breakfast daypart. I noticed a lot of your stores didn't open till about 8:00 AM, which seems a little late given the U.S. typically opens earlier. Is that a problem of addressing the needs status people are on their way to work, is it the price point where people are used to picking up above from a street vendor on their way or what is the issue there?

Emily Chang

Senior Vice President and Chief Marketing Officer, Starbucks China, Starbucks Corp.

A

Okay. First of all, you have to understand a China customer's usage of coffee is very different than the U.S. So in terms of the more – we have 3,300 stores right now, and the portfolio of our stores and office buildings, which is tailored mostly for our morning business and or the similar coffee lifestyle that you have, it's still a small portfolio. And these stores are mainly in key cities like Shanghai, Beijing, Guangzhou and Shenzhen, where big companies will station their offices in these major cities.

So it is truly very different and a lot of our stores – a core majority of our stores are in very prime commercial centers, the shopping malls that were right smack in front of the mall in fantastic locations, and these malls although we have separate entrance, these entertainment centers don't really open until like 10, even, sometimes. So first of all, fundamental difference is the Chinese customers right now are using coffee it's very different and it also has a layer of complexity or differences on different cities and the whole Starbucks journey based on that customer. Does that make sense?

Nick Setyan

Analyst, Wedbush Securities, Inc.

Q

Thank you. Nick Setyan from Wedbush; couple of questions. Number one just a clarification, when you talk about 60% digital pay in terms of a payment of the store then the 80% non-cash, what's that 20% difference?

Emily Chang

Senior Vice President and Chief Marketing Officer, Starbucks China, Starbucks Corp.

A

Okay. Sure. The over 60% refers to WeChat Pay and Alipay specifically. We've got other payment tender types like digital coupons, Apple Pay et cetera. So we add up all the different payment types and you'll see them today when we go in the store. That's where we get to the 80%. And credit cards and UnionPay.

Belinda Wong

Chief Executive Officer-Starbucks China, Starbucks Corp.

A

Yeah. Credit cards really is a majority of the 20%.

Nick Setyan

Analyst, Wedbush Securities, Inc.

Q

Got it. And then just you know you talk about the difference in terms of coffee usage between how we think about in the U.S. and China. Can you maybe compare and contrast the role of the loyalty program in the U.S. versus here China. It seems to me like the point of the loyalty program is to drive frequency in the U.S. Here it seems to me like it's brand affinity more so than anything else. So let me just compare to contrast it to loyalty programs?

Emily Chang

Senior Vice President and Chief Marketing Officer, Starbucks China, Starbucks Corp.

A

Okay.

Belinda Wong

Chief Executive Officer-Starbucks China, Starbucks Corp.

A

I'll start first and I'll pass it to you. So I'm very proud of our MSR program because [ph] look (02:29:16) before that. Our job in the next decade is to have to do two things very well. One is to introduce new customers to Starbucks and the brand and start their journey with the brand. And the other half of the job is once we entered the city and once we touched them, we have to cultivate that relationship with them. So, to make sure they enjoy and they go through the Starbucks journey. So our MSR program, a paid program you heard from Emily, it's something that it's very unique to Starbucks in China where people see that as a status and they're using that as a new customer as well as an existing customer to increase the frequency. So, you want to talk more about the MSR program?

Emily Chang

Senior Vice President and Chief Marketing Officer, Starbucks China, Starbucks Corp.

A

Yeah. I think whether you're in the U.S. or China, My Starbucks Reward program is all about loyalty. It's a foundation of our digital flywheel. It benefits multiple areas. One is, it certainly does represent the power of the brand. In addition, we also see that we have higher frequency of loyalty members versus non-loyalty similar to the U.S. A significant piece of our payment tender is also by our loyalty members. I think it's a mid-30s in the U.S., and it's about 50% here. So what I'd say is our consumers are part of our community, and that's really ultimately what it is when we talk about the 3rd and the 4th place.

Dennis Geiger

Analyst, UBS Securities LLC

Q

Hi. Dennis Geiger, UBS. Scott, we touched on this some at the break and Belinda, you just talked about a balanced approach to growth, but can you just touch on the balance of comps and development going forward thinking about cannibalization? Obviously you've had robust development rates in recent years, comps are industry leading. So that hasn't been an issue thus far, but just thinking about how you manage that going forward would be great? Thanks.

Belinda Wong

Chief Executive Officer-Starbucks China, Starbucks Corp.

A

Okay. This is a real kung fu that we have to learn how to do in the past 19 years and as we accelerate more so, because I think Weiwei touched on it and let me just reiterate. Our growth in China, 75% of that is from new store growth and the rest is from comp. So, it's really a balancing act in terms of the speed of growth in a particular city. If you want to go in and put a handful of new stores, if you want to win quickly, but you know that in a very short time it may impact your existing sales but because we're in this long-term view right, our aim is always to make sure that we capture the market share timely, not too fast, not too slow. So that comp, the balancing of comp that's how we look at it. So it's interesting.

If you think about it, we have 600 stores in Shanghai. Now if I want to post a fantastic comp I can stop growing, but no way. You cannot stop me from growing Shanghai. I'm going to go faster too because this is such a strategic market, but I'm going to do that very thoughtfully and making sure we enter the trading areas, we study it and we enter and then we look at the effect and make sure it is a disciplined growth.

Dennis Geiger

Analyst, UBS Securities LLC

Q

Great. And maybe one more if I could, and Kevin maybe this is for you. Just given the incredible performance that China has demonstrated, what can the rest of the world and even the U.S. learn about the execution, the innovation and the experience in China if you could just touch on that quick? Thanks.

Kevin Johnson

President, Chief Executive Officer & Director, Starbucks Corp.

A

Well, I think as Belinda and the team have demonstrated, and as you'll see this afternoon as you do the emergence and visit stores, I think three things. Number one, the level of store design that they have created is superior to any other market in the world. And so, much of what we've been doing is learning and understanding how we can take some of the innovation that they've done in store design and then bring that to other parts of the world. In fact, Andy Adams who now is running Global Store Development, he came from the team here in China a year-and-a-half ago to run Global Store Development. So we've actually taken talent that was a part of creating the innovation around store design and elevated Andy to a Global Store Development role. And that's what's led to things like the Reserve bars that we're now building in other parts of the world. It's part of what led to the thinking around the Roastery and the Reserve brand, in fact, and what they've done here. So number one is store design.

The second, I think, is the way when they look at food and beverage innovation. And I think food and beverage innovation, we want to leverage, we are a company that leads by differentiating on our beverage and then we attach food, but we realize that even with our core beverages figuring out how to stay true to sort of a coffee forward beverage, but then innovating ways that make those beverages relevant to the market that we're serving. I think they've created a model and approach that we will take you through later today in the product R&D team and you'll get to sample some new beverages and learn how they do it, but it's a combination of the approach and the way they embrace coffee, but then adapt it to things that are unique in that market.

And then third digital, digital in many ways as Emily highlighted with Alibaba and Tencent, the whole digital – the pace of digital innovation in China is greater than that in rest of world. And so I think in many ways for example, the work they did around social gifting and embracing social gifting is an opportunity for us to leverage in other parts of the world. So I think it comes down to the management philosophy that I highlighted in the opening, which is our job is to make sure that we have given Belinda and her team the resources that they need, so that they set up every discipline and function it takes to run a Starbucks and then empower them to do that in a way to bring it to life in China, knowing that the three things that we've got to stay true to our mission, our values and the brand and what you're seeing is a shining example of what happens when you take that philosophy.

John Culver

Group President - International and Channel Development, Starbucks Corp.

A

And let me just add one other thing if I may. I think if you go back in history of our time here in China, right, back prior to 2010, we operated China as Mainland China and – I'm sorry, we operated as Greater China and that encompassed not only Mainland, but also Taiwan as well as Hong Kong. And a lot of the support was coming from Seattle to drive the growth and to put that into context back in 2012 – and I may have my numbers a little bit wrong, but they're pretty close. We had a total of less than 500 stores in China. We operated in 24 cities and that year we had opened less than – I want to say 45 stores. In that time, we made a conscious decision to build the team in China to make the investments, so that they could make the decisions to accelerate the growth.

What did we do? We built a China-based leadership team number one; number two, we invested in design and store development which you'll see; number three, we invested in R&D; number four, we invested in technology; number five, we invested in supply chain. And what you're seeing today is the fruits of those investments paying off. And as we look to the future in China and we say what is the opportunity going forward, we're going to

continue to make investments in this team up here to drive this success and at the same time not only from an infrastructure standpoint, but how do we engage our partners, okay. 15 what was – 15 – how many store managers – we opened 1.5 stores a day in China right. We are adding significantly to the store manager base here, district managers. We've got to make sure we're engaging our partners the right way and that is critical to our success going forward. So, I just wanted to add that. We have time for two more questions.

Matthew DiFrisco

Analyst, Guggenheim Securities LLC

Q

Hi, Matt DiFrisco, Guggenheim. Quick question, I guess, with respect to sort of what we're seeing in the U.S. with the changing of the retail landscape. Can you give us some context here what you're seeing with the 3,300 restaurants and as you described them they're not traditionally intercepting people going to work, but they're sitting in front of malls and big movie theaters? What are you seeing as far as your potential changeover, the pace of changeover of those co-tenants? Are you seeing more restaurants come in and will there be more competition, direct competition in those lifestyle centers over the next coming years?

Belinda Wong

Chief Executive Officer-Starbucks China, Starbucks Corp.

A

Right. Maybe you can add that after I build some context. Well, first of all, China is a developing country, right. So we're very pleased to be able to – while we're growing it in an accelerated pace, we're also entering into these new malls that they're building. And these new – we didn't have – these new malls didn't exist 10 years ago, there is just not a need to overhaul the experience, they're building it that is right for now. So when Emily talked about the OMO experience, the new malls that they're building right now is really an entertainment center and there's a lot of interactive activities to bring crowds in. So the good news is in China, I don't have a problem that there is a lot of traditional malls as already built in the U.S. like what you have and we have to kind of change our model and going in right now to be a part of the entertainment and to bring crowds in so that people can – it's already integrated in the lifestyle when they go out and with the digital, with e-commerce buy and all that lifestyle.

Leo Tsoi

Chief Operating Officer, Starbucks China, Starbucks Corp.

A

I cannot agree more. Actually, what we are seeing in the retail dynamics today in China it is changing very fast. And when we work with the strategic landlords are our partners in the real estate industry, you see that they come to us asking for a differentiated experience because in today's China retail market, people are not just coming in for a coffee. I mean they come in, they want to sit down for a coffee because that's the moment when they want to spend time outside of home, outside of their digital or even stay in our store for the digital experience. So what we have been doing is we've been intentionally created a differentiated portfolio. Example, we saw in a recent mall store that we opened in Tianjin, you are going to see them downstairs in the design studio. That is a third store that we opened in the same mall. And what we've been seeing is – and we're working with the landlord [indiscernible] (02:40:42) that we intentionally elevate the entire store to a completely different manner. And since after the opening, we are seeing even more coffee occasions and customers come into our store, the new one, while it's our – the two existing one, one on downstairs at that the metro, one the other nearby the cinema, they continue to perform as solid as they were. So it says a lot about the occasion that you're able to create for here for the gathering and for differentiation even in the same model we operate.

John Culver

Group President - International and Channel Development, Starbucks Corp.

A

Quick question, Dave

David E. Tarantino

Analyst, Robert W. Baird & Co., Inc.



Yeah. Just a question on volatility and managing the business. One of the things that we saw from other companies is they spun off China, there's variety of reasons that companies do what they do. But one of those is that the business got bigger. And as the business got bigger, the dependence on that business also got greater and the volatility of that market became – it jeopardized the algorithm of the host company. And so there was a capital markets reason perhaps to split it off. You're going the opposite direction. You're kind of streamlining this to be a U.S. and China retail store in a way. But how did the China team think about managing volatility? And then should we just keep our eyes open to the fact that maybe the algorithm will be a little bit more volatile going forward as China becomes a bigger part of the pie?

Kevin Johnson

President, Chief Executive Officer & Director, Starbucks Corp.



I will go and kick off an answer. At this stage of the evolution in China, we felt it was best for us to deploy capital to acquire East China, so we could unify all as one company operated Mainland China. And that's really as recognition that we're in a growth phase right now and that growth phase we felt was best served by being able to deploy capital and get the kinds of return on invested capital that we're getting and to make the investments for the team here to enable us to take the long-term view in building what we believe is a phenomenal asset for our shareholders. And so that's the decision we made and that's why we made that decision.

And clearly the growth numbers that the China leadership team and CAP as John highlighted have been putting up have been accretive to the overall agenda for what we're trying to take the company. And so I think you at this point in our evolution it's going to best serve our shareholders and allow us to capture the opportunity and do it in a way that really empowers this team that you see here today to deliver on the vision that they've outlined for you.

Tom Shaw

Vice President-Investor Relations, Starbucks Corp.

All right. Well, we have plenty more time for questions during the rest of the day, but this will conclude our presentation of webcast today and again, thanks for everybody joining us remotely.

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