Goldman Sachs Global Retail Conference

Company Participants

- Scott Maw, EVP, CFO

Other Participants

- Karen Holthouse, Analyst, Goldman Sachs

Presentation

Karen Holthouse {BIO 17433865 <GO>}

All right. Good afternoon everybody. Thank you for sticking with us till the very end today. I think we have a great closer for you though with Scott Maw, CFO of Starbucks Tom Shaw, Head of Investor Relations. Scott's going to kick us off with about 15 or 20 minutes of prepared remarks and then we will move into Q&A from there. So with that, I will turn it over to Scott.

Scott Maw {BIO 18637895 <GO>}

Thanks Karen. I think I'll start by saying thanks to Karen for giving us the flexibility to have a few prepared remarks at the beginning of the time here. As we got through the last quarter-end and we visited with many of you in this room I think there were a few things that we wanted to make sure were crystal clear coming out of the backend of our last earnings call and specifically some of those things are easier to speak to with pictures so we'll get into that.

On the cover here you have an opening of a Starbucks store in Strasbourg, France. It's a license relationship that we have and you can see that we had a pretty good first day. So let's get into the meat of it if I can get this to advance here. Can we advance the slides? There we go, we went too far. Okay, forward-looking statements, make sure you read those. Just to get into a brief overview. And again I'm going to pick just a few areas to talk about. My goal here is not to stand up and tell the complete story that we normally do at investor presentations but to pick out a few key items and then I think in Q&A we can cover whatever else is on your mind. So the growth algorithm for Starbucks is at least 10% growth on the top-line, 15% to 20% growth on the bottom line, mid-single digit comps in the math of all of that as we should see continued margin expansion into the future. So if you look in the upper left there you can see revenue growth has been in that 10% plus range. In 2015 we had about seven points of contribution from our acquisition of the remaining interest in Starbucks Japan that we didn't own but you know, 10% to 12% over the last few years, we've had nice growth in operating margin, comp store sales growth, 6% to 7% over the last few years. We'll be in the mid-single digits this year and specifically we guided for the Fourth Quarter at a 5% comp for the America's business up from 4% in the most recent quarter and we can talk a little bit more about that as we get into the presentation and into the Q&A.

Non-GAAP earnings per share growing at 15% to 20% a year, we'll be in the 15% to 16% range this year. We had about $145 million year-over-year in partner investments. In 2015 they'll be a similar amount, incremental in 2016 and we'll talk about 2017 when we get into our earnings call but what's important to understand about the earnings growth next year is that we expect at least 15% growth rate on a 52-week basis this year. So we'll have 53 weeks in our year this year just given the vagaries of the retail calendar but that 15% is off of a 52-week basis as we look forward and I'll talk a little bit because I think it was a question on a lot of people's minds of what's the drivers that we have from an earnings gross standpoint to sort of fund those long-term partner and digital investments so I'll get into that a bit more both as it relates to 2016 and then a brief overview of 2017.

Seven strategies for growth; I think a common question that we get is how do we continue to grow a company with $20 billion plus top-line at 10% on the revenue line, 15% to 20% on the bottom line at roughly $5.00 a transaction. How is it possible to do that? And the reality is we continue to have multiple layers and levers of growth and so I'm going to talk about each of these briefly but I want to highlight a couple of those that I'm not going to into detail on the following slides and we'll talk about partners in coffee but on growing the store portfolio, one of the questions I'm getting a lot of is how profitable is the store growth? Are you still seeing the same type of economics? We'll look at that in a slide but how do you have the confidence particularly in the U.S. where you have really good store penetration, how do you have the confidence to continue that portfolio growth rate?

One thing I'll point out on this slide is the types of stores that we're opening today are very different from a mix standpoint than we were opening five years or more ago. So the predominant types of stores that we're opening are drive-through's and those drive-through's are going into outer edges of urban areas or into suburban locations where we don't have the same store penetration as you might see here in the urban side of New York and because the vast majority of those stores are going into those locations there are obviously types of real estate where we don't have the same level of store penetration. We continue to see no net store cannibalization from our new stores net traffic or ticket cannibalization from our new stores so all of those stores are incremental overtime and that 5% growth rate in the U.S. we think that's a number we feel quite confident with as we have more store formats that we use to drive that result. That includes, in addition to drive-through's, smaller footprint stores in places like New York, Boston, Seattle where you might see basically just a walkthrough store, there's no place to sit, you grab your office, we call it an express store, it includes drive-through only stores.

We'll talk in a minute on elevated stores, larger stores sort of bigger stores that have more Reserve coffee capabilities, those will be an increasing part of the mix so we're not building the exact same store portfolio type that we have been over the years and as we expand into those other formats we continue to see the profitability and the incrementality that we've experienced over the years.

Create new customer occasions, that's really about expanding not only in the morning day part but also in the lunch and afternoon and early parts of the evening. We're seeing significant growth at lunch. You all may remember that lunch over the last couple of years has been our fastest-growing day part on a percentage basis. We see that continuing and that's driven obviously by an improved food offering, more fresh food items around bistro boxes and sandwiches but also on the strength of our tea platform, our refreshment platform so on trend more healthful, more natural drink options in addition to the traditional offerings we have.

In the afternoon day part cold brew is really taking hold not only the traditional cold brew that we've had for over a year now but we launched a vanilla sweet cream cold brew and we're rolling Nitro cold brew out in 500 stores by the end of this quarter. And so all of that building on the cold brew platform and capturing traffic and ticket in that afternoon day part.

At home coffee share in occasions so NCPG, that's been growing top-line at 8% to 10% pretty much every quarter. You know, mid-teens profit growth for CPG expanding margins. CPG margin now north of 40%. We see over time the mix of the CPG growth coming from different places so over the last handful of years it's been predominantly taking share in packaged coffee and in K-cups. I think as the K-cup industry growth has slowed we've maintained our share growth results and as we look forward we still think that K-cup and packaged coffee will be the predominant growth drivers for our business but increasingly ready to drink in some of the international partnerships that we've announced in China with a company by the name of Tingyi, we're starting to roll off bottled frappuccino off those Tingyi production lines as we speak. That's a big opportunity in China. Pepsi in Latin America and Anheuser-Busch with ready-to-drink tea we think is a big opportunity in a very fast growing category.

So I think the mix of that CPG growth shifts a bit overtime, perhaps away from a percentage basis from K-cup and roasting ground and picking up in some of those partnerships around ready-to-drink and international.

Let's see, (building) Teavana, I talked about Teavana a little bit in CPG but Teavana and Starbucks stores is a material comp contributor for us over the last eight quarters since we've launched Teavana seven out of eight quarters Teavana has contributed a point of comp. we've started the rollout in Europe. We started the rollout in China, Asia-Pacific having Teavana iced teas in Starbuck stores bringing a higher quality, more innovative platform to those stores than what we had with tea before.

We continued to see limited time offers do very well in the summer. We continue to drive the comp growth that I talked about and I think we're literally just getting started with tea so we see that as a long-term growth opportunity not only down the aisle but I think particularly in Starbucks stores and then I'll talk a bit more about digital.

So let's update you a little bit on store profitability. This goes back to what I was saying before, getting a lot of questions about how new stores are performing. This is a slide that we present occasionally. The last time we presented it was in Investor Day two years ago and it shows U.S., China and Japan which are our three largest markets. They also are the predominant majority of our new store growth and it shows profitability across those both for the store portfolio which is the first three lines and for new stores and as you can see we're up to $1.6 million in AUV in the U.S., about $1.2 million in Japan and approaching $900,000 in China and if you were to normalize all of these numbers and compare them to two years ago and normalize them for FX. So when you go back and look at those slides the numbers might look a little flatter than you see here but if you were to take FX into consideration you actually see China with AUV's pretty close to $900,000 now on a constant dollar basis.

So we're getting good top-line in China. You can see the cash profit in all three markets is very strong. Year 1 AUV's remain very, very strong in all markets and are actually building year-on-year in Japan, China and the U.S. and again the China and Japan ones are impacted as presented a bit by foreign exchange.

Year 1 cash profit is really strong and overall ROI is actually obviously sort of off the charts in China leading the way in overall return. So I think this is my way of trying to communicate to you we still see new stores in our three largest markets performing every bit as strongly as they ever have. We still have the confidence that we'll continue to open those new stores. Obviously we're watching them very closely as we always do with a little bit of comp tick down in the U.S. we redoubled our portfolio review but across the U.S., China and Japan we have very, very few stores that are on our watch list and that aren't performing in line with expectations. So new store growth looks quite strong and we'll continue that.

Okay, this is the picture I wanted to show many of you when I was talking you through kind of Reserve Roastery and premiumisation. So in this pyramid at the top is our Roastery so we have one open in Seattle, we have two that will open in New York and Shanghai over the coming years and we'll have several more that I think we'll announce over the next 12 months or so. We might have as many as ten Roasteries, it could be a little bit more, it could be a little bit less depending on the opportunities but these are really the pinnacle of our coffee expression so if you were to walk into the Roastery in Capitol Hill you would see a menu that's very different than any menu in any Starbucks across the globe; it's a unique menu both from a food standpoint but more importantly from the beverage standpoint. For those of you who haven't been there, there's many different ways to enjoy coffee; pour over, siphon, clover, specifically roasted Reserve coffees on site that you're able to buy from scoop bar and enjoy, unique merchandise, lots of interactive experience with bars with baristas and really again an elevation of those drinks. And one of the things that we're learning in the Roastery is as we roll new drinks and new beverages and they have success in the Roastery so things like Nitro cold brew was initially tried in the Roastery, we're able to learn about those, get them aligned in the right way and then roll them in a number of stores nationally. So I think that will continue.

We've got a wonderful Affogato drink in the Roastery which is ice cream and espresso. I think you'll see that in some stores as we move through 2017 and 2018 and it's just a great sort of laboratory where we have a unique elevated coffee experience for all things for Starbucks Reserve.

Then as you move down there we've talked about, in the next level down, about 500 Reserve stores globally. And by the way, the new Roasteries, New York and Shanghai they'll have Princi foods so when we announced last quarter an investment in a high level really good fresh food Italian bakery that has locations in Florence and London we'll be taking that capability and recipes and putting it in our Roasteries, fresh food baked on site in the Roasteries and that will also be the case in our Reserve stores. So Reserve stores about 500 of those. I think they'll be roughly twice the square footage, maybe a little bit more than an average Starbucks store, they'll have significantly higher AUV, they will still hurdle, they need to meet the profit expectations that we have but think about taking many of the elements that sit in the Roastery bringing them into the Reserve store. Princi fresh foods so an up-leveled food experience and lots of different ways, again, to enjoy up-leveled coffee. So we'll have clover machines in those stores, we'll have a siphon, we'll have pour-over, we'll have a way likely to interact with tea and understand and experience tea in various different ways, more seating and generally an up-leveled experience aligned with where we have Princi Central Kitchens.

Then the next, moving down, we'll probably have about 1500, we're still working out the specific numbers of Starbucks stores that have Reserve bars. Again, these will be higher unit volume stores. They'll probably be slightly larger stores. Again more Reserve capability, more Reserve drinks and varieties and probably multiple ways to enjoy a coffee with pour-over and clover and the like. Those stores are likely to have some of the Princi food in them so whether that's five SKU's or ten SKU's we're still sorting that out but certain high level sort of champion products from the Princi Central Kitchens brought into those up-level coffee (board) stores.

Then we have the other coffee stores, Starbucks stores, today that have Reserve coffees including clover and some pour-over so a little bit more coffee forward but more, I guess, a traditional Starbucks stores and then all of the rest of the cores stores. So the importance of this, as I've taken you through that kind of how things build up, the importance of this is at the very top of the pyramid, the ability to elevate coffee to try new things, to roast and deliver Reserve coffees really flows all of the way down through all of the stores in the pyramid; more in Reserve stores but all of the way down through to traditional Starbucks stores with the goal of elevating coffee and making sure we remind everyone that we still source, roast and deliver the highest quality coffees in the world. So this is the response to the challenges that sometimes come with ubiquity and sometimes come with people saying because I see a lot of Starbucks around the world maybe the coffee is not quite at the same level. Our coffee is every bit as good as it was when we have five stores many, many years ago and I think what we're doing with Reserves helps us make sure we reinforce that with our customers.

Okay, digital and mobile. So mobile payments at 25% of transactions. Mobile order and pay is at 5% of transactions but I think what's important here is it's about 20% of mobile payment, 10% of transactions at peak in about 3000 stores and 20% of transactions that peak in several hundred stores. So mobile order and pay in its very early days we just rolled it fully this month a year ago. So it's only been fully rolled out for a year, is off to a great start and we see at peak in our busiest stores more and more transactions building over time and we'll continue to update you on that.

Loyalty up 18% in members year-over-year. We shifted to a spend-based program in the last quarter away from a frequency-based program. That lower star value and a shift to spend based program really enables some of the partnerships that we've announced particularly the partnership with Chase, the ability to give stars for lower dollar transactions was really important to that so that's part of why we changed the program. One-to-one marketing and personalization is off to a fantastic start. We launched email one-to-one personalized marketing in June and the results there are quite encouraging and then the last thing I want to update you on digital was last quarter we mentioned that there was order consolidation or transaction splitting impact of 1% between ticket and traffic and this was the old program were customers would come in line and split their orders and order a coffee and a bagel and ring them up separately with a barista. That was a change of about 1% last quarter. This quarter we're actually seeing two full points of impact from that. So there was an awful lot of transaction splitting driving unnecessary POS transactions and taking those out (of a line) or better for our customers and better for our partners so significant benefits in the program.

And I think if you add the 5% of mobile order and pay and the two points of order consolidation impact and you think about mobile order and pay growth in the future we could very soon see up to 10% of transactions that used to go through the POS now skipping the POS either through order consolidation or mobile order and pay. Now, we still need the labor behind the bar to make all of those drinks and food but speeding up that line and removing the POS is a great thing for the store and for customers.

So just a couple of points on margin and then I'll wrap up. This year. And by the way, don't take anything from the size of the arrows, they are not drawn to scale on purpose so don't try to view the math. This year when you take a look at margin expansion through the Third Quarter we had about 30 basis points of margin expansion. The big positive drivers in the P&L were sales leverage all up and down the P&L excluding labor and COGS and occupancy, the savings that we've driven where we're targeting about a billion dollars of savings over four years, we got $200 million last year in 2015, we'll get a little bit less than that in 2016 and then as we've lined up our 2017 plan we're likely to see a little bit more than $200 million and that all offsets the partner and digital investments that we're making. So the net of that is positive and we're often asked do you have the levers that you need to be able to fund those partner and digital investments and I think this slide shows that. What I would say further is if you take a look at that 15% to 16% growth that I talked about this year and you put it in the perspective of we have two full points of headwind from FX. And obviously the comp of guidance that we gave at the beginning of the year was somewhat above mid-single digits and now we're in the mid-single digit range primarily driven by what we're seeing in the back half of the year.

So as we started the year we have more FX than we planned for and a little bit lower comp growth than we planned for and yet we're still meeting the targets that we set out at the beginning of the year and that's the flexibility that we have in managing cost of goods sold, managing G&A and pulling other levers within the P&L and balance sheet to make sure we meet our earnings targets.

Looking forward to 2017, I would say it's really a similar set of drivers. Again, really good sales leverage driven by that 10% top-line. Some leverage on COGS and I think increasingly as we move into 2017 some real opportunity in G&A. So at Investor Day two years ago I talked about growing G&A at roughly half the rate of revenue. We did that in 2015. In 2016 frankly we leaned in a bit more on investments and as we look forward to 2017 we see in the core G&A an ability to fund those investments and grow kind of the corporate office functions much lower than the rate of revenue, again, at least half that rate and Kevin Johnson who is our COO and I are kind of teamed as we've gone through our operating plan and we think we'll deliver a year that looks a lot more like 2015 and we think that level of G&A leverage is repeatable year-after-year, again, on the core G&A line and we'll talk more about that in Investor Day.

So with that I'll turn it back over to Karen.

Questions And Answers

Q - Karen Holthouse {BIO 17433865 <GO>}

All right. So I think you for a pretty in-depth review of key issues following the last quarter and I guess one of the things that we talked about a lot on the last conference call was the change in the Loyalty Program and that being a bit of a disruption. You mentioned one-to-one marketing is something that subsequently rolled in June. Could you just sort of walk us through where you think you are in managing through that disruption, normalizing behavior and subsequent to that the ability to go back to pulling some of those digital levers that you have.

A - Scott Maw {BIO 18637895 <GO>}

Right. I think the thing to remember is we changed a lot about the program and I think we knew that there would be some adoption that customers would go through. I think the disruption we saw was obviously a little bit more than we expected which is the nature of your question so just we changed the look and feel of the app, we changed how you navigated within the app, we changed how you earn, how you use rewards and all of that I think required some time for customers to understand that.

So when we look at last quarter we did see a positive contribution to comp from the change in the Loyalty Program it just wasn't as much as we had planned which is a result of that consumer adoption curve. As we've gotten into this quarter we're actually seeing the behavior normalize. Now, we still have a ways to go I think to get back to the business case we initially had and see that comp growth contribution which is still positive but not quite what we thought it would be but one of the things that's interesting is when we first launched the program we actually saw reward redemptions drop pretty significantly and I think that was because people were trying to figure out how do I go from 12 stars to 125 stars and how does this all work? Since that in the months subsequent we've actually seen that behavior come all the way back to where it was before. So I think people are normalizing relatively quickly and I do think the tools that we have with personalization and the big data partnership that we have with the company called Takt which is a joint venture between us and BCG, I do think that big data has helped us steer towards those customers where we saw a little bit of change in that behavior and just remind them and maybe educate them a bit on how the program works and so as time goes on and we move from the email one-to-one marketing capability into in-app capability which will come in the next couple of months, I think the acceleration of understanding of the program will happen and then I also think we can start to really drive the spend-based behavior that we think we can through some of the offers and one-to-one.

Q - Karen Holthouse {BIO 17433865 <GO>}

Actually that was going to be my next question that working with a partner with some of these data capabilities is a little bit new to Starbucks and I think the internal development of a lot of the intellectual property and IT around the app and the POS system has been a pretty big competitive advantage. So what were the decisions that drove looking externally for sort of a big data partner, how do you think about that relationship evolving over time and are there any other sort of areas where you would think you might need some more scale to do what you want to do?

A - Scott Maw {BIO 18637895 <GO>}

Yes, I think we're always looking particularly in the IT space for ways where we can go faster. What are those things that we want to develop ourselves and really own the IP, own the resource and own 100% of the learning's and what are some of those things where we can partner with someone that might be a little bit further ahead of us or have more capability and move faster and that was really the case with Takt. And so we still have all of the IP, we still own all of the data, all of the algorithms and how we analyze things and how we run our campaigns, what we market to whom, that's still all within our control and the data analytics are within our control. What (TACT) has done a fantastic job of is using AWS and all of the services they have in staging that data, bringing in new data capabilities so we've talked bout things about more real-time weather capabilities coming into that database and how you stage and structure the relationship of that data. It's relatively complicated and they're really good at it but the real core of how we analyze the IP and the customer data that all still sits with Starbucks but to get to the nub of your question, it was really about speed and the fact that we can make an investment in them and drive things quicker was compelling.

Q - Karen Holthouse {BIO 17433865 <GO>}

On even sort of specifically on the digital side we have seen just looking at year-over-year growth some moderation in the pace of (active by) Starbucks Rewards members that started before the switch over and the program and do you think of sort of the opportunity or the comp sales opportunity there evolving towards how do you better manipulate behavior within sort of the people you have versus the acquisition of new customers?

A - Scott Maw {BIO 18637895 <GO>}

Right.

Q - Karen Holthouse {BIO 17433865 <GO>}

Or new people into that umbrella?

A - Scott Maw {BIO 18637895 <GO>}

I think it's a combination of both. What I would say is by understanding the behavior of our customers, both individually and then in groups, what types of things motivate people when the weather is hot in the south? What types of things motivate people with certain products that they buy and what's the propensity to buy those same products and importantly what's those -- what has a high propensity of attaching with that transaction? And so we're able to learn that about you given the data that you've given us through your transaction history and Starbucks Rewards that importantly we're able to learn more about people like you in geography cuts or behavioral cuts or product related cuts and all of that makes us smarter and so as we launch our campaigns learn from the results, adjust and then launch the next campaign. We're always getting a bit smarter and a bit more targeted.

And so I think that we've seen, I don't think we have seen a significant contribution to our comps over the last couple of years, from our ability to analyze that data. This is a huge step forward in the level of contribution that comes from those customers.

I do think inherent to your question, it's important. That's about a third of our transaction so while it's really important and those are our highest spending customers Starbucks Rewards members spend roughly three times a much as non-Starbucks Rewards so it's a meaningful portion of what we do, we're also doing a number of things for those customers that aren't Starbucks Rewards; both for them to understand the benefits of the program, expand the benefits of the program through things like the Spotify music service, I think the Chase relationship with the debit card is another way to remind people of all of the benefits that they can get in new ways with the Starbucks program but also trying to make sure that we have things that resonate with those customers that aren't Starbucks Rewards members. So that's where some of our limited time offering, some of the up-leveling we're doing in coffee. We've done some things around frappuccino happy hour obviously this year, we'd like to have done that better but that really resonates with those customers. We have Treat Receipt that resonates with those customers so we try to take a holistic view but the more we can build that program the more people we can get to understand the program and join it, the better off we are.

Q - Karen Holthouse {BIO 17433865 <GO>}

That makes perfect sense. So you mentioned it briefly in your presentation that your partner investments are still a reality next year and then there might be some opportunities to moderate the pace of G&A growth and thinking about that, are there particular areas where you see that opportunity or maybe particularly on the technology side where there's been some frontloaded spend versus the ultimate benefit?

A - Scott Maw {BIO 18637895 <GO>}

Yep, I think the biggest opportunity in G&A is really in all core G&A investments which would include IT systems and support at the backend. And we'll still grow G&A in those spaces so when I say half of revenue, right, that's 5% for Starbucks so it's not like we're going down to 0% G&A growth but that does require us because we have so much growth and we have so many initiatives to grow that 10%. It does require us to make tradeoffs. So if you asked me, what are the two things that you have to do to get that right? We have to continue to prioritize very well within Starbucks not only what we're going to do, which were usually pretty good at prioritization, prioritizing what we're going to do. But importantly what we're going to step away from and I think that's the message we're building overtime and I have to give a ton of credit to Kevin Johnson in building that muscle and sort of making it a part of what we do operationally and then I think the other thing, opportunity we have is just in all things processed in Starbucks and so I would say from the moment I joined five years ago it's a fantastic company, it's still somewhat of like a $20 billion growth company and so as you look at the back office processes we have even in finance there's just ways for us to be more efficient with how we use the headcount that we have.

Q - Karen Holthouse {BIO 17433865 <GO>}

Makes perfect sense as well. So one of the things that you also addressed in your prepared remarks was unit economics which continue to be just phenomenal, for any company much less a company of the size of Starbucks and thinking about earning 60% new returns on capital are there opportunities to drive that higher? So I guess you know, within that what drove the improvement from an update two years ago to the update we saw today and then why not be growing units faster? With unit economics that are that strong, why not try and go and capture that as quickly as you can?

A - Scott Maw {BIO 18637895 <GO>}

Right. I think what we've been able to do is lean in a little bit on the portfolio growth rate but overtime I think that portfolio growth rate we're quite comfortable with. What we're -- so the number of units will go up as a result. So it's not -- I know you know this, we're not holding store count for flat, we're growing it, we'll do 1850 this year or so, we'll do more next year and so we are growing that unit growth but I think what we've learned through some rough times is stretching on that is sort of where you can get yourself in a little bit of a challenge and so in China actually the portfolio growth rate a couple of years ago was up in the 30's and that's come down into the mid 20's. we think that's a fine growth rate. The number of units will continue to grow, in China we'll open new markets but the vast majority of that unit growth will go in existing markets, the 10 or so largest cities that we're in in China because of the efficiencies we get with consumer recognition and convenience of having a better network obviously we get supply chain efficiencies in that equation but in the U.S. I think we're happy with the 5%, the different store formats are so important I think if we had to open 5% portfolio growth in core traditional Starbucks stores in urban markets we'd be super challenged with that but by going out and being flexible with stores, by using segmentation that gives us an increased level of confidence but I wouldn't see a big ramp in the near-term.

Q - Karen Holthouse {BIO 17433865 <GO>}

And it's interesting in the U.S. that the sort of alternative store footprint went from a sort of concept to a material part of the growth story really quickly which I think is a testament to the success of those sort of footprints, has that changed your thoughts about unit opportunities in other parts of the world when you think about density and real estate as a real challenge in parts of Asia, drive-through maybe in more suburban parts of Europe, just is that -- has it changed your thinking elsewhere?

A - Scott Maw {BIO 18637895 <GO>}

It has. It's a really good point. So I would say if you look at the drive-through's that we're opening, for example, in Japan, a few years ago it was zero but now we see a significant opportunity, we're starting to open drive-through's and I think as we think over the next few years that will be a meaningful part of the mix. The same thing is true in the U.K., we're so central in urban areas particularly around London that as we get out into the suburbs, again, we're opening drive-through's. The net openings in the U.K. is relatively flat but we're closing some stores that are under performing and opening more drive-through's. So I think -- and as we get in China we see similar opportunities and then importantly those Reserve stores that I talked about, the 500, those will be international so we see lots of opportunities for Reserve stores in cities like Shanghai. We probably already have a few Reserve bars in China just because we have up-level coffee locations there. We have some of those here in the U.S. and so I think we'll continue to both open new coffee forward stores, slightly larger footprint stores, as well as when we upgrade and renovate existing stores adding in some of that capability.

Q - Karen Holthouse {BIO 17433865 <GO>}

And changing tact's just a little bit (that) acquisition of a new bakery brand is -- we haven't seen an acquisition in a while, there is a little bit of a streak and then grew into those. How do you think about other parts of the portfolio that there really is an opportunity to fill in a gap with a potential acquisition or maybe not even fill in a gap but when you think about being sort of a tastemaker or a leader in what people want to be consuming, where do you think there's an opportunity for people, a growth market that we're sort of headed towards?

A - Scott Maw {BIO 18637895 <GO>}

Right. I think we'll continue to look for opportunities for categories in our stores so I do think what we've done with La Boulange and the upper end of what we'll do with Princi including -- and Evolution Fresh represents the types of opportunities that exist within stores, either in existing categories or new categories we might go into and the theme there is actually pretty consistent. What we want is whether it's food or juice or tea, we want a quality level and capability that our partners and our stores are proud of. So just as proud as they would be knowing how careful we are about sourcing and roasting Starbucks coffee, we want them to feel the same way about Evolution Fresh and La Boulange food and now Princi in select stores. And so I think there's categories we're always looking at. I think some of those are existing that we have in our stores that third-parties are doing and some of those are newer things that we're looking at and we kick the tires on a lot of different things, nothing specifically is rising to the top. And then we always look at M&A if you want to call it transactions where we're acquiring or divesting a stakes internationally. Japan's a large example of that but we're looking at those all of the time over time and there could be -- sorry Karen one thing, there could be more category opportunities internationally not necessarily size but number than in the U.S. over the near-term so we look at things all of the time in Europe and in China in categories where we think a third party might bring us an advantage whether it's a JV or a commercial agreement or an acquisition.

Q - Karen Holthouse {BIO 17433865 <GO>}

I think one of the things that's interesting about the ability to bring new products in stores is that that ultimately creates a way to see customer awareness of the brand trial within a store that they obviously trust and then that can ultimately lead to CPG opportunities.

A - Scott Maw {BIO 18637895 <GO>}

Right.

Q - Karen Holthouse {BIO 17433865 <GO>}

And we're starting to see that with Teavana, with ready-to-drink tea in the U.S. and thinking about, we've had a couple of new partnerships that have been announced, how quickly can those products, do you think, ramp to sort of a full distribution model as you're sort of starting from scratch on a product and are there any other areas as you're thinking about potential acquisitions that CPG could really help drive an attractive category or where you would be looking?

A - Scott Maw {BIO 18637895 <GO>}

Yes, I think the bottled frappuccino products will begin to add real revenue growth in CPG in China this year. I think the longer-term opportunity, I get pretty excited about but I think it's -- you know, we're talking several years to get at it is ready-to-drink tea and if you look at how much growth in the category between coffee and tea from bottled beverages, how much faster it's growing than overall ready-to-drink. I think there's significant opportunity there. Teavana is reinforced in soon to be 10's of thousands of stores globally and so could Teavana tea down the aisle at some point get somewhat as big as frappuccino, I don't want to get too carried away but I do think the market is there and I think over many years through development with Anheuser-Busch and their distribution capabilities I think that could be a significant add to overall profitability.

As far as additional categories, I think tea down the aisle as well, introducing Teavana tea down the aisle so we have a nice little business and Tazo tea does really well, great profitability, could Teavana come in down the aisle in the super premium category with Tazo with the premium category and have a really good relationship there? I look at Starbucks and SBC that works really well, those brands are very complimentary; one in super premium, one in premium, both of them growing sales in profitability quite nicely. So again, I think that's over time but there's opportunity there.

Q - Karen Holthouse {BIO 17433865 <GO>}

Switching back to the store, you mentioned lunch in your prepared remarks is maybe a little bit of an underappreciated story on the food side which we've said for years. Thinking about percentage growth that's been the strongest part, our impression has been that breakfast sandwiches has sort of been the dollar engine of where you've gotten that food growth from. When you think about breakfast versus maybe midday and then addressing the evenings platform which has sort of come in and out of the conversation, over time, what sort of inning of the game do you think you are in terms of driving food attachment and those different pieces or in the afternoon and evening even just new food traffic versus attachment?

A - Scott Maw {BIO 18637895 <GO>}

Yes, I think breakfast sandwiches there's still room to go so I would say middle innings there and I would just look at I think a year ago maybe a little bit more we launched a double smoked bacon sandwich in the stores and we saw a significant uptick and sustained uptick in sales and breakfast sandwiches as a result of that. So I think as we look at both more indulgent and we have some better for you tings on the docket that I can't disclose yet but I've tasted them and they're quite good, I think breakfast sandwiches has room to grow and you're right, it is a big part of the dollar growth that we've seen but more to come.

Lunch is the percentage growth driver and I think grab and go fresh food is a huge opportunity for us. There's opportunity in sandwich and prepared lunch in the afternoon for sure but I think grab and go and just continuing to add and up-level our salads and bistro boxes. And again I've sampled some of those things and you'll see some of that in 2017 to continue to drive lunch growth around food, higher than the rest of the day. Then I think evenings it's still early days. We're in several hundred stores. There's some encouraging results there, there's some things I think we have to reevaluate and work on particularly from a food platform standpoint.

Q - Karen Holthouse {BIO 17433865 <GO>}

Great. Well I think you guys are going up against a pretty tight flight schedule so I want to make sure we end on time and wish you luck in getting to JFK in less than an hour and a half which is not always possible. Thank you, everybody else for being at the conference today and hopefully we will see you again tomorrow.

A - Scott Maw {BIO 18637895 <GO>}

Thanks Karen, thanks everyone.