Wolfe Consumer | Starbucks (SBUX) CFO Fireside Chat

Company Participants

- Patrick Grismer, Executive Vice President and Chief Financial Officer

Other Participants

- Fred Wightman, Analyst, Wolfe Research
- Greg Badishkanian, Analyst, Wolfe Research

Presentation

Greg Badishkanian {BIO 1750188 <GO>}

So it's a real pleasure to have Pat and Durga with us today. Pat was going to say few opening comments for few minutes. And then we'll jump into Q&A. And I'd also mentioned, please e-mail, Fred or myself or Katherine, or enter it into the computer, few of additional questions, we're sure to ask those as well. Go ahead, Pat. Thanks for joining us.

Patrick Grismer {BIO 15965217 <GO>}

Thank you very much, Greg. Certainly appreciate the opportunity to participate in today's conference. But before we do get started with our fireside chat, I do want to highlight the key themes of last week's Investor Day and provide a quick update on our sales recovery in our two lead growth markets, the U.S. and China. I will be speaking to some slides that are now posted to our Investor Relations website. And so I'll start with our standard cautionary language here, as I will be making some forward looking statements.

To summarize last week's Investor Day, we truly believe that Starbucks is stronger and more resilient than ever. First, we've rapidly adapted to changes in consumer behavior, leaning into digital and accelerating the repositioning of our business in dense metro areas in the U.S. Second, we have a long runway of healthy growth ahead, even from our current position of global scale. Third, we expect to sustain double digit growth at scale, with improving margins and returns targeting an ongoing growth rate of 10% to 12% of non-GAAP EPS.

So now moving to a quick sales update, starting with the U.S., we continue to expect full comp recovery in the U.S. by the end of fiscal Q2, even with the impact of the recent surge in COVID-19 cases, and how that has affected customer mobility in the U.S. recently, due to various government imposed operating restrictions across several states. Note that we saw a slight sequential improvement in comp as we entered our fiscal Q1 from minus 4% in September to minus 3% in October, then decelerating a bit to minus 4% in November, with further softening now in the month of December. So our business is being impacted by the current surge, but not nearly to the extent that we were seeing in the spring, as we've built a new level of resilience in our operations and customers are also showing resilience, knowing that they can safely visit our stores given our trusted operating protocols.

You'll see that we've noted compound two year comps at the bottom of the slide, as that's what we'll be monitoring as we begin to lap material impacts of COVID-19 from last year, starting in the month of March. And to note that our two year comps were already positive in the last three months. So let's move to China. We continue to expect full comp recovery there by the end of fiscal Q1. And as you can see, there is been some choppiness in our monthly comps recently. We moved from 1% comp growth in September to 11% comp growth in October, although that included a seven point seasonal benefits shift from September.

Then similar to the U.S. we saw a deceleration from October's normalized growth of 4% with comp growth returning to 1% in November. And in the current month in December, we're seeing strengthening relative to November reinforcing our belief in full comp recovery as we exit Q1, even excluding the temporary VAT benefit. And similar to the U.S. we've noted compound two year comps at the bottom of the slide and you can see that we've been running solidly positive there for the past three months. So what does this mean for the quarter, our EPS guidance remains intact, as margin strength offsets softer than expected sales. And to help with modeling, we're now providing comp guidance for the quarter as it comes to a close with the U.S. landing in a range of minus 6% to minus 5%, improved from Q4 of fiscal '20, which was minus 9%. And with China landing in a range of plus 4% to plus 5%, also improved from the previous quarter, which we reported at minus 3%. And I confidently reaffirm our EPS guidance for Q1 and the full year as noted with non-GAAP EPS ranging from $0.50 to $0.55 to Q1 and from $2.70 to $2.90 for the full year.

And so with that, I'm happy to take your questions, what I'm first going to do is stop sharing my screen. And as I mentioned, these slides are posted to our investor relations website for investors and analysts to study, and really happy to now move to your questions. Thanks very much.

Questions And Answers

Q - Greg Badishkanian {BIO 1750188 <GO>}

Awesome. Thanks, Pat. Yeah, we also saw that from Brinker [ph] as well, that slowed down in December and their pre-announcement today.

A - Patrick Grismer {BIO 15965217 <GO>}

The other thing, I was just going to add -- the other thing was, I think, notable U.S. retail sales were reported this morning and there was, I think, a one point deceleration from October into November, which mirrors the slight deceleration that we saw in our business from October into November.

Q - Greg Badishkanian {BIO 1750188 <GO>}

Yeah, absolutely. And just kind of as it relates to that, you're expecting the U.S. business to improve at some point and recover during the March quarter. You talked about kind of your numbers running around that negative 4% during September and improving. But we're still a little bit away from that. So what gets you over the final hump, what gets you over there? And is it -- what are the drivers, you think it's just greater frequency with existing guests, is the return to a more normalized school and work schedules? Is it a vaccine? What is it that's going to get you to a more normalized levels?

A - Patrick Grismer {BIO 15965217 <GO>}

Great question, Greg. There are really three key drivers that I would highlight, and part of our thinking is predicated on what we've observed in markets around the world that have these kind of searches and impacts and what we've seen is relative to the initial surge, the impact is far less pronounced, which is what we're seeing it's far less pronounced, not nearly as deep and it doesn't last for as long. That said, what we're expecting in the U.S. is that there will be some relaxation of government restrictions, as we move into our second fiscal quarter. With that, we expect also ongoing normalization of customer routines, as we saw transpire across the summer into the fall. And then we're not standing still, we have business driving initiatives lined up, in the areas of digital customer engagement, average innovation and continuing to elevate the customer experience by elevating partner experience, which we believe is the number one driver of comps, and so that work continues. So, really a combination of a relaxation of government restrictions, ongoing normalization of customer behaviors and routines, and our business driving initiatives that we have planned for our second quarter.

Q - Greg Badishkanian {BIO 1750188 <GO>}

Okay. All right. Another question, just one of the points that Kevin made in his presentation last week, with the potential resurgence for in-person consumption as behaviors begin to normalize. And you've historically seen big in-person destination customers coming to your stores. But a lot of focus has been on drive throughs this year as well. So how do those factors balance out when you're thinking about it?

A - Patrick Grismer {BIO 15965217 <GO>}

Well, I think your word of balance is the right way to think about it, because it's important to remember that even prior to the pandemic, in our U.S. business, 80% of our sales were -- what we call OTW, out the window. Combination of drive through or coming into the cafe to pickup averages (inaudible). The other 20% then being occasions that were more sit and stay occasions. And so, we've already had, I think a pretty healthy balance between that convenience occasion. And what people have thought of us, the traditional third place experience, the way we think about it, is it all transactions? Whether sit and stay or out the window, our third place experience transactions, because they all involve engagement with our partners, which is our fundamental part of the overall Starbucks Experience. So even though we have the leaning in more to drive through in other convenience channels, because that's where consumers want to be met during this time. We recognize the importance of offering our cafes for the sit and stay experience, that customers are craving.

And as Kevin mentioned at the Investor Day last week, as we were able to progressively open our cafes even for limited seating, the impact was immediate. So as we've had to dial back with these new operating protocols that we've had, that's what has impacted our business here more recently. So we fully expect that as those operating restrictions are lifted over time, we will be able to dial back up in a way, that allows customers who are eager to come back into the cafes, and have that sit and stay experience to complement the more convenient occasions, that they wish to have from time-to-time, will see that ongoing recovery in our business. So for us it's about making sure that every Starbucks customer experience has that third place dealing to it, because that's what our customers enjoy; that's what they appreciate; and that's what they're craving.

Q - Greg Badishkanian {BIO 1750188 <GO>}

Alright. So your China business back to positive comps in September, can you talk about what if any differences that you've seen in the China recovery relative to the U.S. recovery?

A - Patrick Grismer {BIO 15965217 <GO>}

Well, there is no denying the fact, that the market itself has followed a very different path toward recovery. The market overall has enjoyed a -- I would say, a steadier recovery, a more controlled recovery, a more disciplined recovery. And of course that has not been the case in the U.S. What has been an area of exposure for us in China is the restriction on international travel. And so as a consequence, as we worked our way back towards full recovery, the team in China has had to focus on replacing transactions that have been displaced, because inbound international travel is still restricted.

So the part of our business that relied on inbound international travel, whether business travel or tourism, that continues to be a gap in our business relative to pre-pandemic levels. But the team has innovated and worked quickly to replace those transactions, and that was -- that is what has enabled them to achieve our full comp recovery, as I've reinforced here by the end of our Q1, as we enter our Q2, and as the number support.

Q - Greg Badishkanian {BIO 1750188 <GO>}

Right. And just kind of looking at the development over the next three years, we saw that development really ramp up, and how does that fit into unit development income targets that you outlined last week?

A - Patrick Grismer {BIO 15965217 <GO>}

Development is a critically important part of our overall growth equation. As you know, we talked about last week, the fact that we see our way to approximately 55,000 stores globally by 2030, up from just under 33,000 today. So we have a long runway for growth. What that looks like near in -- what we outlook here in the U.S. is about 3% growth, which I think is quite remarkable for a concept of our scale. We already have more than 15,000 locations here in the U.S. So very substantial scale. And yet, there remain significant development opportunity for us. Now that is largely concentrated in parts of the U.S. where Starbucks concept is less well represented. In the center of the country, in the Southeast and very heavily focused on drive throughs which are high volume, high margin operations. That's not to say that there won't be development of other concepts, in fact, as we've talked about trade area transformation in the U.S., we've talked about a repositioning of our real estate in those markets.

So as we close under-performing units, we will be opening new units. Some of them will be these new formats that we've talked about, others will be more traditional cafes, that will be, enhanced in their designed to better cater to the type of experience. Customers are looking for, which is increasingly about convenience. But development remains a very strong part of our overall growth equation. Not only in China, where as you know, we're growing at a very fast pace, but also in the U.S. which many consider it to be a mature and heavily penetrated market, so Starbucks is still has significant growth potential.

Q - Greg Badishkanian {BIO 1750188 <GO>}

And with respect to the U.S., it's an acceleration over what you've done historically, like to say the last three years. So what gives you the confidence reaccelerate it now?

A - Patrick Grismer {BIO 15965217 <GO>}

Good question. I think it's important to pick apart, what happened in the last couple of years. When you look at fiscal '19, we came in at around 3%, so on the low end of the guidance we've given 3% to 4%, but that reflected what I would characterize as opportunistic closures later in the year. As the year was unfolding and we were seeing improving performance. For example, in Q3 we posted a 7% comp in the U.S., in Q4, we posted a 6%. So as the business was accelerating, we saw the opportunity to accelerate some closure, just think about it, as an early innings of trade area transformation. We didn't announce trade area transformation and the acceleration of our plans until we were in the midst of the pandemic in June of 2020. But even in the year before we saw the opportunity to pick-up the pace of some of the closure, some of the underperforming units. And so that weighed on our net unit growth in fiscal '19. And then you look at fiscal '20, we came in closer to 2%. But bear in mind, there were two things going on. Number one, the pandemic which disrupted our business and we had to hit the pause button on new store openings for a while. And so, we weren't getting the absolute new store openings that we had originally planned. And we announced trade area transformation and acceleration of that in a very significant way.

So we picked up the pace of closures in the back half of the year. The combination of those two dynamics yielded net growth of about 2%. And then this year, fiscal '21, with outlook just slightly positive. And that is entirely due to the accelerated closures under trade area transformation. Because the absolute store openings north of 800, are very robust and we expect that new pace, that absolute pace of store growth to continue across the planning horizon, that we've guided, with Investor day last week.

And the closures will moderate because as we accelerate all these closures into fiscal '21, we'll see a lower rate of what I would characterize as ongoing closures. So it's -- you have to really pick apart, what happened in fiscal '19, fiscal '20, look at the composition of fiscal '21. And I believe that lens, even more credibility to the about 3% growth that we've outlooked for the U.S. net, over the next, well through fiscal '24.

Q - Fred Wightman {BIO 20893264 <GO>}

Greg, you're on mute.

Q - Greg Badishkanian {BIO 1750188 <GO>}

Great. Thanks. And let me turn it over. Thanks, Fred to -- I'm going to turn it over to Fred Wightman on my team. Thanks Pat.

A - Patrick Grismer {BIO 15965217 <GO>}

Thanks, Greg.

Q - Fred Wightman {BIO 20893264 <GO>}

Perfect. Hey, Pat, thanks again for the time. If I could just trouble you to -- I know that you posted the slides on the investor deck, if you can just went through there on your IR site. Would you mind just running through sort of the prepared remarks again, for those final three slides? We had a few people reach out asking just for clarifications, so it would be really helpful if you don't mind, just...

A - Patrick Grismer {BIO 15965217 <GO>}

No. Happy to do that. So starting with the U.S., we continue to expect full comp recovery in the U.S., by the end of our fiscal second quarter, even with the impact of the recent surge in COVID-19 cases, and how that has affected customer mobility in the U.S. recently, due to government imposed operating restrictions across several states.

We did see a slight sequential improvement in comp, as we entered our fiscal Q1, so that was moving from a minus 4%, as we reported for the month of September, so minus 3% in October. That been slightly decelerated to minus 4% in November. And we are seeing further softening here in the month of December. So our business is being impacted by the current surge, but not nearly to the extent that we were in the spring, as we've built a new level of resilience into our operations and customers are also showing resilience, knowing that they can safely visit our stores, given our trusted operating protocols. And the audience will also note, we've shown the two-year comps, which is something that we're monitoring, particularly as we start to lap the more material impacts of COVID-19 from fiscal '20, starting in the month of March.

Now moving on to China, we continue to expect full comp recovery there by the end of our fiscal Q1, which is the end of this month, end of December. And you'll see from the slides, there has been some choppiness in monthly comps here recently.

We move from a plus 1% comp in September to plus 11% in October, but that 11% included a 7.0 [ph] seasonal benefit shift from September. So maybe normalized more like 4%, that's slightly decelerated much like the U.S. into the month of November, where we saw a plus 1%. And then in the current-month of December, we're actually seeing strengthening in China, relative to the month of November. And so that reinforces our belief in a full comp recovery, as we exit Q1, even excluding the temporary VAT benefit. And then, so much of the U.S., we noted the two-year comps.

And then close with that last slide, which is again posted to our IR website. What it means, what this all means for the quarter, EPS guidance remains intact. As margin strength offsets the softer than expected sales and actually to help with modeling what we're providing, because we've not provided comp guidance for Q1. But as we're approaching the end of the quarter, we wanted to share an outlook. And with the impact of this recent surge here in the U.S., we're expecting Q1 comp to land in the range of minus 6% to minus 5%. And in China, we're expecting it to land in the range of plus 4% to plus 5%. And in both cases, I think quite notable improvements versus the prior quarter Q4 fiscal '20, U.S. had come in at minus 9%. So now we're out looking sequential improvement to a range of minus 6% to minus 5%. China had come in, in Q4 at minus 3% and we're out looking plus 4% to plus 5%.

I also on the very last slide reaffirmed our EPS guidance for Q1 and the full year, as noted on the slide, that's for non-GAAP EPS.

Q - Fred Wightman {BIO 20893264 <GO>}

Perfect. Super helpful. Thank you. And sorry to make you to do that twice.

A - Patrick Grismer {BIO 15965217 <GO>}

No worries.

Q - Fred Wightman {BIO 20893264 <GO>}

We've a fair amount of people reach out, so just wanted to clarify that. Maybe just one quick follow-up on the December comments for the U.S. Will you remind us sort of seasonally what percent of mix that month is given the holiday SKU [ph]. And then, I know you had made some comments about gift card business specifically at the Investor Day. Any change to what you're seeing there or expectations? That would be helpful.

A - Patrick Grismer {BIO 15965217 <GO>}

So I don't know that we've ever disclosed what December is specifically. We have talked about Q1 being a seasonally high quarter for us. So the holiday season is important to us overall. I don't know that we've shared the specifics, but that can be -- I think derived from some of our past disclosures, because we do provide U.S. specific sales. So it's an important quarter to us. So, it is unfortunate that we are seeing this impact at this time. Nonetheless, we remain confident that we will fully recover by the end of our Q2. And then in relation to gift card sales, as you would expect with limited customer mobility with restricted access to our cafes, where we tend to sell many of our gift cards, not exclusively, because we sell through other channels, including digitally. But we are seeing impact, and so there will be some impact to our gift card sales this holiday season, which will likely have some knock-on effect to our fiscal second quarter. But I think it's early to say whether that will be a material impact.

Q - Fred Wightman {BIO 20893264 <GO>}

Perfect. And then just maybe take a longer-term view, if you look at the operating margin. Our operating margin guidance you guys provided last week you talked about 40 basis points sounds like it's tied directly to that portfolio of optimization. But can you talk about the other building blocks to give you the improved confidence in that outlook? And then how we should think about sort of the sequencing and the impact on the P&L over the next few years?

A - Patrick Grismer {BIO 15965217 <GO>}

Absolutely. I would highlight two key levers, driving that margin improvement beyond the boost that we get from trade area transformation, as we talked about. And that would be the stronger comp, so we've taken up our comp outlook globally from a range of 3% to 4% to a range of 4% to 5%, there is significant operating leverage in our business. And so that provides a significant capacity for us to make the incremental investments, that we believe are absolutely essential to our ability to deliver that top line. But at the same time, we are sustaining disciplined cost management and that's across every cost line in the business.

As you'll recall from last year, we made significant progress with the deployment of labor in our stores, with new tools that we introduced towards the end of fiscal '19. Tools that have a machine learning capability that enable us to improve or refine the manner in which we are allocating store labor hours, in a much more efficient fashion. So disciplined store labor allocation or deployment is an important one. I would continue to highlight what we see by way of significant supply chain savings, which we continue to deliver, given our growing global scale and how we're able to leverage that to our advantage.

And the third would be, G&A, I would say that there is a new level of discipline, in terms of how we manage G&A. And make no mistake as a growth company, we will continue to invest in G&A, importantly in areas like technology and data analytics. Things that are instrumental to our ability to drive the top line, but we will be very disciplined in how we find offsets, so that we can contain G&A growth to a fraction of our top line growth, so that we can unlock margins, margin efficiencies that enable us to deliver that, that margin improvement, that we outlooked over the next three years.

Q - Fred Wightman {BIO 20893264 <GO>}

And one of the things that you just mentioned was labor efficiency. Subsequent to the Investor Day, I think Kevin made some comments about moving all of your partners to $15 per hour in terms of wage. Was that contemplated in the operating margin guidance? And how does that sort of that commentary fit into the outlook?

A - Patrick Grismer {BIO 15965217 <GO>}

Yes, it is contemplated in the outlook that we provided. And specifically provided for in our fiscal '21 plan and underpinning our guidance for fiscal '21. As it relates to future years, we've made provisions for those investments. At the same time, we're continuing to work on the funding vehicles, which will include outsized sales growth, because we do expect a return on these investments, as well as additional operating efficiencies. So that work is still underway, but we remain very confident in our ability to find the offsets necessary to pay for those investments, to deliver the top line growth that we're out looking. And the one thing, I want to clarify for everyone is, well, is that when we outlook for example in the U.S. 4% to 5%, that is the projection that we're providing, that we are committing to. But as you know from this last year pre-COVID, we have the capacity, we have the potential to deliver above that amount. Q3 and Q4 of last year plus 7% and plus 6%, Q1 -- I'm sorry, fiscal '19, and then Q1 of fiscal '20, before the onset of the pandemic, plus 6%.

So our business has the potential given the strength of our brand and the focus of our investments, particularly around our partners and digital to punch above that 45%, providing the capacity necessary, but we're going to be very thoughtful about how we pace and sequence these investments. We're very much committed to delivering stronger wages and benefits. We've been an industry leader for years. We're going to maintain that leadership position and reward our partners in a way that we believe is appropriate. We're going to be very thoughtful about the pacing and sequencing, making sure that we also have the funding vehicles to preserve the margin guidance that we provided. But we remain very optimistic about our ability to continue to enhance the profitability of our business, even as we make these significant investments which we believe are absolutely essential to our brand positioning.

Q - Fred Wightman {BIO 20893264 <GO>}

Great. Super helpful answer. Thank you. One of the other things that we've got a few inbound questions -- have to be Investor Day, was the potential licensing opportunity, if you had alluded to. You gave some color on the potential sales and margin impact, we do move forward with that. But can you maybe talk a bit more strategically about why this is the right time to be exploring that process? And then what some of the milestones are that we should keep an eye out for over the next few years?

A - Patrick Grismer {BIO 15965217 <GO>}

Absolutely. So I think it was about 2.5 years ago that company management gave a presentation at an investor conference and unveiled the Growth at Scale agenda. And a fundamental aspect or dimension of the Growth at Scale agenda are streamline. It was about simplifying the business and tightening the company's growth agenda. And in fact, over the last two years a series of transactions have been completed. Licensing transactions, divestitures like Teavana, Tazo, Global Coffee Alliance, which fundamentally moved the Channel Development business to a license model. So all those transactions contributed significantly to the simplification or the streamlining of the organization, and provided management the focus that we believe strongly contributed to the improved operating results, we saw over the last couple of years prior to the temporary impact of the pandemic.

And so we believe that continued streamlining through these licensing transactions has the potential to further advance the management focus and the simplification of our company, in ways that we'll further enhance performance. At the same time, as I highlighted last week bringing the potential to improve our margins and our return in invested capital. So we see it as an extension of streamlining activities completed over the last two to three years, with a potential to enhance our business. I would say there is no special urgency and we think that these things will take time, anyway to pull together. And to do them the right way, because what we want to make sure of, is that we have the right partners, who have the commitment to the brand and the capacity to invest behind the continued growth of the brand, in order to sustain the growth of the business and realize the full potential of Starbucks.

Q - Fred Wightman {BIO 20893264 <GO>}

Perfect. Greg, I think that does it. I think we're out of time.

Q - Greg Badishkanian {BIO 1750188 <GO>}

Great, Pat. Thank you very much for joining us today. Really appreciate all the follow-up, especially after your Investor Day, is really helpful.

A - Patrick Grismer {BIO 15965217 <GO>}

Our pleasure. Thank you for having us. Have a great day. Bye-bye.

Q - Greg Badishkanian {BIO 1750188 <GO>}

Take care.