Bank of America Merrill Lynch Consumer & Retail Conference

Company Participants

- Charlie Jemley, SVP, CFO of China Asia Pacific and Channel Development
- Joe Buckley, Analyst
- Scott Maw, CFO

Other Participants

- Unidentified Participant, Analyst, Unknown

Presentation

Joe Buckley {BIO 1491816 <GO>}

(inaudible) Buckley, Bank of America Merrill Lynch's Restaurant Analyst. Very pleased to be hosting Starbucks today as our keynote address through this lunch gathering. Representing the Company today will be Scott Maw, Chief Financial Officer and Charlie Jemley, Senior Vice President and Chief Financial Officer of the China Asia Pacific and Channel Development Businesses at Starbucks.

Our format will be exactly what we've been doing so far -- Q&A, where I'll be asking a couple of questions. But again, we encourage questions from the audience. (Conference instructions)

With that, let me turn it over to Scott. Scott, thank you for joining us.

Scott Maw {BIO 18637895 <GO>}

Thanks, Joe. Good afternoon, everyone. Before I get into the meat of the presentation, I just want to talk a bit about the picture that you see up here on the screen. So this is our Reserve roasting and tasting room in Seattle. When you walk in here, you'll see up to 40 partners, our employees, working at once unpacking green beans, roasting coffee, packaging coffee for shipment, scooping coffee for you to consume at home. And delivering coffee for consumption on the site and to go in pour-over, in siphon, Clover, espresso, lots of different presentations.

And we believe this is really the pinnacle of retail coffee experience and a pinnacle of any retail experience you can get because you actually get to see the product made on site and then choose how you wish to consume some of the finest-quality coffees in the world.

What I would say is it's off to a great start. The transaction volume and customer volume is way above what we expected when we opened. There are lines every day; sometimes they snake outside onto the sidewalk in front of the building into the wonderful February weather in Seattle. So very popular among customers. We know we have a great concept here with the Roastery.

And I think it reemphasizes our leadership position in premium quality coffee and the fact that we source, roast. And serve the highest-quality coffee in the world. And the Roastery's certainly an experience in that. So if you're in Seattle, I encourage you to go.

Forward-looking statements -- please read those.

Just quickly -- I think most of you know this -- so Starbucks has almost 22,000 locations in 66 countries around the world.

Revenues this year will approach $20 billion.

You can see the revenue growth that we've had in the double digits, operating margin expansion over the last few years.

Comp sales growth of at least 5% for 20 straight quarters now for Starbucks.

I think, importantly, within the most recent quarter we had two points of transaction growth. And just to put that in perspective from a sales standpoint, to get two points of transaction growth globally for Starbucks, that's 12 million incremental transactions across the system in the quarter. So if you just think about the size of that number we need to get to drive a comp sales growth, it sort of puts in perspective what we're doing.

Earnings per share -- our target is 15% to 20% over the long term, 16% to 18% this year. You can see we've been running, on average, slightly above our long-term forecast. Part of that's been coffee and part of that's been fantastic execution, which we'll talk more about as we get into the details.

The other thing that's important to point out, I think particularly emphasized in the last quarter, is the breadth and balance of our growth. Whether it's revenue growth, which you can see across the three different geographies that we have; margin growth across those geographies; dollar expansion and percentage expansion in margin; and then, channel development. And top line, bottom line. And margin expansion, very, very balanced.

And the most recent quarter was a perfect example of that. We grew transactions substantially in all three regions -- channel development, once again, hit that (inaudible) revenue growth. And we had margin expansion in virtually every part of the business. So that balanced growth becomes more and more important as, obviously, our international operations are growing a bit faster than the US operations.

I think a really important question to ask is how does this $20 billion company continue to grow the top line at 10% while growing the bottom line at 15% to 20%? It's a pretty big task. And the key is, as it's been in the past, we have multiple layers of growth opportunities. And we've talked about that for the last couple of years. And I'll take you through that.

I think importantly, we have a strategic framework that we developed over the last year and a half or so that's really focused those growth opportunities in seven different categories. And so that's why I want to talk about the business today. Charlie and I can go deep into the individual P&Ls of all the business units in Q&A if you want. But it's really important to understand all the growth opportunities we see across these seven strategies and what we think it can mean for the overall profitabilities or for the business over the long term.

So first and most important, quite simply is we want to be the employer of choice. We call our employees partners and that's partly because they have ownership in the Company. Our stock-based equity programs go very deep -- down into the store at the barista level.

We've always had compensation and benefits that are significantly above where the rest of the industry is. And that's included health care at 20 hours a week long before the Affordable Care Act. We've had that in place and it kicks in at 20 hours.

That includes beverage on shift. It now, starting in January, includes food on shift for our partners, which both gives them a nice benefit and reinforces the quality of food that we have in our store, particularly since the Lava Lunch [ph] launch.

It includes (inaudible) stock, as I mentioned; the College Achievement Plan, which gives them benefits at their junior senior year in college and opens up college education for many of our partners, as well as a broad base pay and incentive pay for our managers.

We talked a bit on the most recent call about some investments we're making. Those investments kicked in primarily in January. So again, the food benefit I talked about; a broad impact of base pay raises, start pay raises, across the market. There's no targeted number of any market -- we did market-based cost of living adjusted raises. And so by each market, the percentage and the amount is different. We felt very good about the money that we've put to work in there.

We made those decisions back in the summer. I know other amounts changes. And we think that's a good thing, recently. But our changes were actually decided on, put in place, in the summer and went into full effect in January.

One thing that's on this slide that's important and we'll talk about more as we move through time is an investment in technology and tools for our partners in the stores. So while the technology we have that faces our customers, which we'll talk about, we think is leading the industry, I think in the stores, around the POS, inventory capability, mobile apps for our partners, scheduling capability -- all of that we're probably around the median and we want to be leading.

So as we get through the end of this year and into next year, you'll see us talk about and quantify for you a number of investments we want to make in technology and tools that will make things easier and faster in our partners. And we're going through a big assessment of that as we speak.

Second, we want to lead in coffee. So we have a lot of things. And we'll talk about the opportunities that are going on in our stores around additional bay [ph] parts and opportunities we see in food. But at its core, Starbucks wants to lead in coffee. And I think the pinnacle of this discussion is the Reserve store that I showed you earlier. But it goes further than that, beyond the Roastery.

So it includes general broadening of the Reserve product line. So putting Reserve coffees and Clover machines in more stores and more places and more countries around the world. And we certainly accelerated that. And I think the Roastery gives us a unique capability to even broaden that and deepen that further.

It includes pour-overs in more markets. China, Charlie can talk about, has a great coffee experience in many of our stores around pour-overs. And gives customers a chance to interact with baristas and understand coffee better.

Importantly, it includes agronomy. So we have a number of farmer support centers around the world where we work with farmers to improve yield, to understand fertilizer, to understand the risk around rust, which is a risk for coffee plants in many parts of the world. And allows us to make sure we understand and invest in a sustainable set of practices across the globe.

Then increasingly, our beverage innovation includes things like iced teas and other things. But it also includes core coffee drinks like the flat white that we just launched, which is off to a great start.

And again, our ability to execute and source high-quality espresso, make that in store, allows us to broaden out innovation in what I would call core coffee beverage. So coffee's critical.

Growing the store portfolio. So you can see the targets up there -- both in total in country. We'll have 1650 new stores this year. Over half of those are in China Asia-Pacific. The US and Americas comes in at 650 and EMEA at 150. And increasingly, what gives us confidence around this is additional analytics and capabilities around a broad base of store formats.

So we've been opening in the US, as an example, an increasing percentage of drive-through stores that have an eat-in aspect and a drive-through aspect. Those stores have higher AUDs [ph] on average, higher profitability on average. And higher total return on average than a store that just has eat-in only. So we're continuing to broaden out drive-throughs.

Beyond that traditional drive-through we have a couple of handfuls of drive-through-only stores. So in markets and geographies where we would normally not build a Starbucks store -- it could be an industrial area that has a high amount of vehicle traffic; it could be in a transitional area where we can't get a full footprint in but we can get a pad and put a drive-through-only in -- those are stores where we see opportunities to put real estate and stores in where we weren't able to go before. A lot of those stores are already over $1 million in AUD and trending right up toward the portfolio average.

In addition, we have smaller-footprint stores, which include kiosks. You can see there a mobile store. So that's for things like college campuses and other places where we have the ability to be for part of the day. Making sure we get the execution right, we get the menu right. And we think we've got some opportunity there.

And it includes small-footprint stores. So there's several of these that I see just walking around in New York. So places where either because of economics or just lack of space we can't put a full Starbucks store with dine-in seating, we're able to put a small store. If any of you came out to Investor Day, you saw an example of this that we actually built in our headquarters, where it's basically a walk-through store. You walk in one door, you order, you walk out the other door.

All of this is opening up real estate opportunities. It gives us a chance to segment and add stores. Flagship stores, like the store in downtown Disney, which has given an incredible volume. A great investment for both us and Disney.

As we broaden out that tool kit and broaden out our mindset around the types of stores we can build, we've got increased confidence both in the US and globally in hitting those numbers. And so far, over the last couple of years, the stores that we have opened are as profitable as many stores we've opened in our history. So things are working well.

Incremental occasions. And a lot of this is around food. But it's also around beverage. So we continue to want to own the morning. This is things like our improved breakfast sandwich platform, which we launched last March. And we're still seeing a 29% lift in the most recent quarter in total breakfast sandwich sales.

We launched a new breakfast sandwich over the last week or two called the double smoked bacon -- I think that's right; John's checking me on that. It's a fantastic sandwich but it's a new introduction and we'll see opportunities in the morning day part, offers like SKUs, limited-time offers, to continue to drive that breakfast occasion.

Then at lunch, we've seen food growth at lunch; it's the highest part of our day part for food as far as growth standpoint is concerned. So percentage growth, it's not necessarily dollars. And lunch has grown at 14% to 15% over the last two quarters. And we see an additional opportunity to continue to see lunch grow kind of in that teens growth rate over the next few years. So lunch will be the largest percentage growth for us.

We've been up-leveling the lunch platform, actually for a number of years. We recently launched a couple of sandwiches, really with the Lava Lunch [ph], influence will continue to roll out and replace and up-level additional SKUs in lunch as time goes by.

In the afternoon, it's really about refreshments and snacks for us. It's about having relevant, refreshing drinks. So things like Teavana shakes and iced teas, which we saw were a big hit this summer. And we're actually up 20% year over year, even in the most recent quarter. Obviously it's winter out. So to see that kind of growth in iced tea signifies that we have a winner in Teavana.

There are other things in that refreshment platform like Fizzio, like refreshers. And snacks that go along with it. And again, I want to emphasize that that 11.00 to 3.00 day part, those four hours, is where we've seen our highest comp growth over a one; and two-year period in most of our quarters over the last couple of years.

So we continue to see outsize growth in lunch, even before we fully roll out the rest of the lunch food platform.

Then, evenings. We have about 30 evening stores today. We've tested all for different concepts and formats. We think we have a winner now; we'll probably open several hundred stores at the end of this year. We think evenings can be up to 20% of our total portfolio. It has unique foods offering in the US, which includes small plates that can be shared. Obviously, beer and wine is part of the ticket.

But when we look at the average ticket, we see a good mix between food, beer and wine. And core drinks. So people will come in, a small group, they'll order something to share, one or two will get beer or wine, some will get espresso or a tea drink, generally a little bit larger ticket. And it allows us to capture a bit more traffic in a day part that's a little bit lower in volume for us.

CPG. So lots of opportunities in CPG. And for us it's really about meeting our customers where they are. So whether they're on the go or at home, in the grocery store, we want to be able to have relevant offerings for our customers via CPG. And there's two big growth opportunities to focus on right now in CPG; there are others. But two major growth drivers over the next five years.

The first is to continue to extend our lead in single serve. So this is primarily K-cup in the USA. We've seen significant growth. We hit a No. 1 share, most recently in the last quarter; that's been a share position we've traded on and off a little bit with one of our competitors. But generally at the top of the share list in K-cups. And we've really grown that over the last few years by expanding choice for our customers.

So we know we occupy a premium space within the grocery aisle around flavor profile and offering of product. And we also knew we have opportunities to continue to add SKUs, whether it's flavored SKUs like cinnamon [ph] dolce or mocha, single origin coffees -- every time we add and innovate around those SKUs, we generally see a pickup in volume. And so we have a lot of things lined up with Green Mountain to continue that momentum that we've had to date.

The other opportunity in CPG is really around international. And probably the biggest near-term opportunity within that is ready to drink. So when you look at ready to drink internationally, we're in 21 countries already. We think there's a significant opportunity both to expand the countries we're in in ready to drink -- for example, in China -- and also drive increased market share. We know we can get the recipes right, we know we can get the distribution right. We just have to put it all together and drive the growth.

So CPG will continue to grow roughly at the rate it's grown over the last few years.

Next is tea. So we've talked about Teavana already. The biggest opportunity for us is today and it's happening today in Starbucks stores. We've talked about iced tea. Hot Teavana tea products launched fully across the US in January. So all the chai tea, hot tea offerings are now Teavana. And again, we continue to see lift both in price point and in unit volume as we introduce Teavana. So we know we have a winner.

We'll continue to test and learn and understand the tea bar concept. We have about six across the US, several of them here in New York. And we want to see what the concept might work, what it looks like. And then how we'll roll that across the country.

And last but not least, all things digital and mobile. It's really important to focus on what we call the echo system here. We have the Starbucks card, where one in six Americans got a Starbucks card last holiday.

We have the rewards program. So once you get a card, we try to get you to register it for the Starbucks reward program, which is a great thing for our customers and a great thing for us. We can understand what your likes are, what behavior is over time. And we can do marketing that's relevant to you and helpful for us.

Then, the mobile payment program more and more has functionality. Not only just pay but, as we've launched in Portland, an ability to actually order and pay and walk into the store and pick up and really skip the line in the ordering line.

You can see some of the transactions there -- we're now at 16% of transactions on a mobile device. We expect that to continue to go up; that's doubled over the last year or two. And we'll continue to drive more mobile and MSR adoption through mobile order and pay.

And soon -- to be launched this summer -- mobile order, pay. And deliver. So the ability to have Starbucks deliver to you where you are at home or at work.

On mobile order and pay we launched in Portland in December with 150 stores. We'll launch in the next two weeks in the Northwest, where we'll have 600 stores. And the launch in Portland has gone very well, both from a qualitative standpoint -- all the financial metrics that we're seeing there are at or above our expectations.

And the qualitative aspects, the impacts on customers and partners, that's running ahead of where we expected as well. It's dead easy for our customers. It's fully integrated into the app. It's easy for our partners because it's fully integrated into the POS and the drink production system that we have today. And so we're seeing a really good start in Portland.

MSR, I talked about. I think what's important is the chart on the right. We're in very early days of growing our MSR population and growing our capability within the Company to mine that data and provide relevant offers and marketing to our customers. And so we're starting to see some very early good results there, as you can see. But we're just getting started in all things digital. But particularly in the MSR one-to-one marketing space.

I dropped a slide somewhere. But that's okay. The slide -- let's see if it's next; hold on. No, okay. I'm going to talk about it instead. The slide that was there was just around coffee prices. And I'll just say a quick reminder -- we're 94% price-locked for 2015. We're starting to price 2016.

I think as you all know, we didn't buy a lot of coffee when it spiked up generally above 180 on the seed price. Just the fundamentals that we saw and heard coming out of origins didn't really support that level of price. And of course, it's a good thing that we were right and coffee has come down into our target price and we've priced a significant amount of coffee.

As we get closer to 2016, we'll talk more about how that's shaping up, given our activities further out on the curve.

Cash returns to shareholders -- as you can see, they've ramped up nicely. Operating cash flow growing almost 30%. So we still are generating a ton of cash in the business; we're returning that through a dividend that's generally grown over the years. And we'll continue to pay out within that 35% to 45% dividend payout ratio. There's an opportunity to move up a bit within that.

Then, share buybacks generally equal to offset dilution. Again, we'll lean one way or the other depending on cash needs and market conditions around that.

So there's the seven strategies in 20 minutes or less. Underneath that, it's important -- I'll just say a couple of things around some specific margin improvement initiatives that underlie all of that, which are really around driving COGS improvement.

So last year, we had $150 million of rate-related P&L savings from our supply chain that we realized. This year, that number will be about $200 million. And over the course of four years, that'll add up to $1 billion. So we have momentum, we have specific work streams to drive that. It's real rate savings in the P&L and we're off to a great start already this year.

G&A and support costs -- we reduced our run rate by about half from -- generally we've been growing G&A and support costs about equal to revenue. This year we're trying to grow at half that rate. And that math works out to be about $100 million in savings.

That's getting reinvested; it's all in our forecast numbers. But it's important that we free that up, that expense investment, up for other things that we prioritize as growth opportunities in the business.

That's really all this says. This slide basically says COGS and G&A have been growing equal to revenue. We grow revenue double digits; that just doesn't work mathematically. It's not an equation that we love. We want to get leverage in COGS and G&A and so you can see the math of what the opportunity is for us.

Oh, there's the coffee slide. Sorry -- it just got in a different order than what I had. There it is. So really all this says is if you look at the spike that happened in the middle of last year, we weren't buying in that time frame and as it's dipped down we've purchased up to 94%. That's really all that says.

As far as long-term targets, comp growth in the mid-single digits.

Revenue growth of 10% or more. This year we want G&A growth to be half of revenue growth. Going forward, that relationship between revenue and G&A, we want a few points of a gap between revenue growth and G&A growth. I'm not sure half the rate makes sense just given the growth of the Company and the things we want to invest in. But if we can have a few points of a gap in between there.

Long-term EPS growth of 15% to 20%. And ROIC of over 25% and increasing by 50 to 100 basis points a year.

So that's kind of our target.

And when you add it all up, as I mentioned at the beginning, we have a clear execution framework. And innovation is a core competency for Starbucks. I got a question earlier today -- what innovation is the most exciting to me? Really, you have to narrow it down a little bit. We have significant product innovation, we have significant innovation within our digital capabilities, we have innovation in beverage execution, we have innovation around Reserve coffee. It's just what we do at Starbucks is we drive innovation. And that fuels growth.

We have fantastic operations, both in the US and internationally with Charlie and John Culver driving the operations in Asia and Kris Engskov running EMEA, which has been a tremendous turnaround story for us. And strong financial discipline with what we see as some incremental margin opportunities to help us fuel growth in the near term. Okay?

Joe Buckley {BIO 1491816 <GO>}

Okay. Scott, thank you very much. I'll lead off the Q&A. And again, if there's question from the audience, please raise your hand.

Scott, could you talk about the recent management changes at Starbucks? Troy Alstead taking a leave and Kevin Johnson joining the Company from the Board to be Chief Operating Officer.

Scott Maw {BIO 18637895 <GO>}

Yes. So they're two different things that sort of aligned for us in January. In the most recent investor day that we had in November, Troy was all in, very involved in preparing and presenting during that investor day. Then he took a bit of time off around the holidays, had some discussions with his family and did a lot of thinking.

And decided to take advantage of a great benefit that we have at Starbucks that we call the Coffee Break. It's a sabbatical. And it gives up to a year off for people that have been at least 10 years at Starbucks. And I think Troy had been thinking about that for some period of time.

But I think the stars aligned for him around a number of fronts to do it now. No, 1, his oldest is reaching the end of high school years and so I think if Troy wanted to spend the maximum amount of time with his family, this was the last real window before they started graduating kids and having them move out.

I think if Troy was here, he would tell you he has a very level of confidence in management with John and Cliff and Kris really driving the operation. You've got people like Adam Brotman running the digital capability. There's just a lot of substantial leadership and tenured leadership across the Starbucks continuum. So I think when he looked at how well the business was doing as we exited the quarter, I think he had a lot of confidence he was leaving us in good hands.

And we'll miss Troy. I'll probably miss him as much as anyone; he's a fantastic executive and a great person to have at Starbucks. But you certainly have to respect the courage and the prioritization that he had to pull this off. So we all feel really good for Troy and a little bit sad that he's leaving.

Then separately from that, Kevin Johnson, who has been a very active Board member for years with Starbucks, definitely on the active side of all Board members, involved in audit [ph] committee and just involved with us pretty deeply in general, had been having some discussions with Howard about are there things that Kevin can do more? Kevin's still pretty young; he's in his 50s. And I think was enjoying the Starbucks story, enjoying being involved in that. But wanted to go deeper.

And so I think those two things came together. And with Kevin's significant and deep international operations experience and his great technology background. And given where our growth is, probably disproportionately towards tech and disproportionately towards international, it was -- as Howard said, we had a No. 1 pick that we could put in the spot as things lined up.

Kevin is already digging in. I have many emails on my phone that I haven't been able to get back to him on already. So he's going to pick up in a lot of places where Troy left off. Helping work with me around driving prioritization, bringing that operations team together to drive around our priorities, getting the supply chain and IT connected in the right way with the business.

Then, Kevin will have his own agenda of things around IT and digital and how we run and measure the business. So he's off to a great start already.

Joe Buckley {BIO 1491816 <GO>}

Charlie, if I could take advantage of your presence with us here today, can you tell us a little bit about Starbucks' business in China? How the Chinese consumer uses the brand, how the brand is positioned versus what we're used to in the United States. And maybe talk about some of the growth.

Charlie Jemley {BIO 20239120 <GO>}

Yes. There's a lot of similarities between the businesses -- that's the good thing. But we do have some differences. More of an afternoon business, obviously, versus a morning. Our stores are very little take-away, large party size. Blended is probably more important in Asia than it is in the US.

And we have very little customization at this point, which I think is a big upside for us. Which means that while people enjoy the brand, they enjoy the third [ph] place atmosphere, they haven't yet attached the coffee yet, which is the big up side.

Scott mentioned, in terms of innovation, we're really excited about Reserve and pour-over. And we've got pour-over bars in China now that we have open and they're doing very well. Not only for the customers who get to sit and enjoy the pour-over experience. But for the customers in the queue or in the rest of the store watching what's going on. So there's a bit of theater. So there's an observational theater aspect to it that they get to pick up on.

And they may not go over to the bar, they may not be comfortable just yet doing that. But they see it and observe it. Then, that sort of fits to the Chinese tea culture, the pour-over nature.

So there's a lot of both product and experience innovation that we're doing in China that I think separates us from competition that's gone very well.

Scott Maw {BIO 18637895 <GO>}

How is the brand from a price point relative to the US, given the income differences between China and the United States? (inaudible) how it works for you.

Charlie Jemley {BIO 20239120 <GO>}

First thing I would say about that is just relative to our competitors, we've very similarly priced. But if you do an affordability index, the math would tell you that it's a more luxurious purchase in China than it is in the US.

But that's never. And doesn’t appear to be, an impediment at all. We don't have the high degree of frequency yet so we have a lot of room in price to go, I think. So even though we're, on a relative basis, maybe a little bit more expensive purchase. But everybody in there with us is in a very similar price position. So we're pretty comfortable where we sit on that.

And we have great design, great stores. Again, I talk about pour-over, a very good experience. People gather in our stores and stay for a long time so they see the value they're getting. It's not just about what's in the cup, it is about the experience. And because they take time in the experience, I don't think the price actually manifests itself as a value issue for them.

Scott Maw {BIO 18637895 <GO>}

And the only thing I would add to that -- it's really well said -- is the price that we charge largely reflects the cost of doing business in China. There are very real costs to making sure we have the supply chain right, costs to making sure we have real estate right. And so that all goes into the price that we charge. And I think many of our competitors' charges are comparable.

Joe Buckley {BIO 1491816 <GO>}

Scott, one for you, back to the Americas. You guys hosted a very thorough and interesting investor day at the end of last year. One of the things that stood out is that although the margins in the Americas segment are at all-time record levels, you envision them going higher over the next five years.

Could you talk a little bit about the components of that? And some of it is top-line driven, I know. And some of it is cost driven. Just your confidence in achieving that goal.

Scott Maw {BIO 18637895 <GO>}

Confidence is high. If you break it down, when you take mid-single-digit comps and you take the even historic expansion that we have and you lever across that across that fixed cost infrastructure, we get a fair bit of operating leverage. I think when you add on top of that the COGS savings and some things we can do around support costs, broadly G&A, that contributes to margin.

What offsets that. And I think rightfully so, will be a number of investments. So even mobile order and pay, as fantastic as we all think it's going to be -- and I'm at the top of that list -- there's an investment curve at the front end where it'll be a little bit of a margin drag.

But I think most importantly, Joe, is the investment that we're making in partners. That number, I think rightfully so, is the biggest investment we'll make across the Company this year. And that will have an impact on margins and we're happy to do it.

So I think it's about continuing to operationally and for our customers drive the right level of traffic, launch things like mobile order and pay, which has a little bit of a front-end investment, then is extremely accretive and transaction accretive.

Then, taking that fixed cost leverage and all the things that come off that healthy growth and reinvesting in partners and the next thing that's coming along around delivery. Other investments we'll want to make around product launches. And so that's kind of how we think about it.

To put some numbers on it, I would expect -- so it's a great big business in the US. I would expect margins to expand several tens of basis points every year. There might be a quarter here and there when we lean in on investment a little bit or there might be a quarter here and there where there's a little bit more tailwind. But I would expect to see sort of 30 to 50 basis points of margin expansion over time in that US business.

Joe Buckley {BIO 1491816 <GO>}

Okay. You talked about mobile a little bit. And I know you launched it in Portland, I guess just a couple of months ago, in the beginning of December. Very few companies sort of launch in their first live market and also disclose plans to be fully rolled out within 12 months. I've followed Starbucks for a long time; I wasn't shocked. But talk about your early experiences and the confidence in rolling it out so rapidly over next year, this calendar year.

Scott Maw {BIO 18637895 <GO>}

I think -- I talked a little bit about this. But the qualitative aspects; think about the modeling that we did. We have a very, I think, appropriate model that we think is going to drive significant value for us as we grow out mobile order and pay.

Early days -- a couple of months in. That trajectory across all the measures -- incrementality, MRS signup, all the things that we measure -- it's right on or above that model. So we're really happy about that start.

It's 150 stores in Portland. So it's a meaningful market. But obviously we'll continue to learn as we go through, rolling out 600 incremental stores. So quantitatively, it's quite encouraging and we'll continue to measure that. And as we get further into it, we'll share some of those specifics with you.

I think qualitatively is where it's running ahead of plan. And so the ease of understanding it from a partner standpoint -- I told you this story before. But we sent out a training video to our partners. And because the system is so integrated in what we do every day, the training video is almost exclusively about what the customer goes through. It's not actually, hey, here's all the things you have to do differently for mobile order and pay because there really aren't many.

It comes into the POS just like every other transaction. If something goes wrong, you can pull that transaction up with the customer there and make a change; you don't have to go to a POS in the cloud or a different spot in the store. Go through the same production line over to the same hand-off plane. And so it's highly intuitive for our partners.

And because customers have responded favorably, partners are happy. It reduces the amount of time waiting at the POS.

Then, customers are learning and loving it. So there is some in-store marketing, we did some out-of-store marketing. So the understanding and the adoption curve is moving along nicely. And generally what we find is if customers don't know about it and they see it in action in the store, they'll ask questions of either another customer or a barista. And they're really trying to learn and understand and perhaps sign up.

So a couple of months into it, Portland's gone very well.

The other thing that we haven't talked much about but Adam would tell you is we expect, when we roll a major app like this, to have some hot fixes we needed to do. We haven't had any of those yet, knock on wood.

We don't have Android Robot yet; it's just IOS. So we know that'll be a significant lift within a few months when we get that ready.

There's some capabilities around understanding inventory trends so that we know whether items are likely to be out or in stock. That capability hasn't been added to the app yet; that's coming. All of that is just going to be additive to the experience.

Joe Buckley {BIO 1491816 <GO>}

In the Portland market, have you found it more effective in a different type of footprint that Starbucks has -- urban stores or drive-throughs or suburban stores. Has it varied by the types of store?

Scott Maw {BIO 18637895 <GO>}

We know the answer to that question. But we haven't disclosed it yet. What I would say is common sense just tells you in highly busy both urban and suburban stores -- I think a lot of people think it's just going to be in those in-city markets that have a big peak in the morning. I think we'll see a benefit in urban, suburban stores that have heavy traffic at peak. And I think we'll see the benefit throughout the day.

But our modeling is based upon a disproportionate share of that benefit at peak in our busiest stores, which just makes sense. That's where the lines are the longest and that's where people want that choice.

I think it's important to note as we've rolled drive-through out over the last 10 years or so. And given customers that choice, as I mentioned, those stores perform far better than stores that don't have a drive-through. And I really think mobile order and pay taps that same opportunity.

So for us, what we see with our customers is drive-through's about convenience, it's about speed, it's about how I want to interact with Starbucks. And really, mobile order and pay follows that same trajectory.

Joe Buckley {BIO 1491816 <GO>}

If there are questions in the audience, please raise your hand. If not, I'm going to keep proceeding here.

Scott, one more maybe on the mobile ordering. It's easy to understand how that eases things at the point of sale. What is the impact on the production and how is it faster and more efficient?

Scott Maw {BIO 18637895 <GO>}

We have the ability in virtually all of our stores to add additional staffing, even at peak. And so as those stores have more transactions, the labor system gives them more labor, they earn labor. And that labor depends on the number of transactions, the type of transactions based upon complexity, more warming of food versus less.

And so as transactions go up. And we think they will at peak, we'll be able to add more staff and move things through.

Joe Buckley {BIO 1491816 <GO>}

We have a question in the audience.

Questions And Answers

Q - Unidentified Participant

What happens to Troy when his coffee break is over?

A - Scott Maw {BIO 18637895 <GO>}

Well we hope he comes back. I certainly hope he comes back. And I'm planning on it.

Q - Unidentified Participant

Okay. And assuming he does come back, what would he do?

A - Scott Maw {BIO 18637895 <GO>}

I think that's one of the things that I think Troy has to decide and we have to decide. I think if he was here he would say a year is a long time. As he sits today, he only knows, working at Starbucks, he loves the Company deeply. And so I think he wants to come back.

How that changes over the course of the next year, who knows? I'm not even sure Troy knows. Then, does he want to come back into a 100-mile-an-hour job or does he want to find something that's maybe a little bit more balanced? I don't know.

But I think if he wants to come back, there's no end of work that we can do with Troy at Starbucks. There's lots of things he can do to help us. That would be a good problem to have.

A - Joe Buckley {BIO 1491816 <GO>}

You have a question over here.

Q - Unidentified Participant

I had a question on your Chinese stores. You said they're primarily, like, afternoon day part. Is there any initiative to drive more of a morning kind of coffee or is there just different consumption pattern where that's just not the main form of consumption, usage, case the Chinese consumers have?

A - Charlie Jemley {BIO 20239120 <GO>}

I think -- we segment our stores in China. So if we're in an office tower, we may have a different initiative there. But I think primarily food. I think as we up-level the coffee experience -- we talked about Reserve. Pour-over may not be something in the morning because people are in a hurry. But as we sort of dial up knowledge and use of coffee, then that sort of fits in the morning day part along with food.

So there's lots of ways that we can turn on the mornings. But it'll take a little bit longer to build that versus what we have in the afternoons, just given the habit. The last shoe to drop from dinner to lunch to morning is kind of the way people consume, not just in our business but other businesses. So the morning being the most habitual home thing. At some point that code will be cracked as well.

A - Joe Buckley {BIO 1491816 <GO>}

Scott, can you talk about the recent increase in -- I'm trying to think, you mentioned the food and the beverage for your partners, for your workers. Also the wage increases that have been implemented. Just the thought process around that.

A - Scott Maw {BIO 18637895 <GO>}

I think if you look over time, we've had a significant difference between the benefits and pay that we offer and sort of the rest of the industry. And that difference drives significant -- we have lower turnover at the manager and barista level, higher employee satisfaction. And we know that is the single biggest key to success for Starbucks and success in the stores. There's just no doubt about it.

And so as we got into the summer we started to look at, how -- are there ways out there where we truly can bolster that difference and invest in it? And so for us naturally being already ahead of Affordable Care Act in health care, with the stock benefit, we naturally started looking at cash compensation. Again, this was back in August.

We started looking at a food benefit, which we'd been talking about for a while. It just makes so much sense for us given where food's going for Starbucks. And so we put those into our plan and we executed them, really before some of the recent changes were announced. We understand, while others in the space have done that. But we had this lined up and ready to go for a number of months now.

And I think, honestly, Joe, that would be something that we look at and we watch every year. It's not that we haven't been increasing Starbucks wage [ph] and we haven't been increasing wages -- we have some about that we add every year. This year we said that if we try to take a deep look and take a bigger step to reach down that path. And I think there'll be more of that as we look in the future, whether it's cash compensation or the technology investments I've talked about. We've got to make sure that we're disproportionately investing in our partners.

Q - Unidentified Participant

I have a question about sourcing and supply chain. Can you speak to your forward-looking vision with respect to sourcing of coffee in terms of differentiation, cost advantages, and relative sustainability?

A - Scott Maw {BIO 18637895 <GO>}

Right. The key to our coffee sourcing is what we call cafe practices. And cafe practices is our collection of safe sustainability initiatives. And they include everything from farmer financing to cultivation on the farm -- all the aspects of everything that goes into developing a sustainable supply chain.

They are up to or better than fair trade, frankly. And we are over 90% cafe-practice certified. We actually certify and audit cafe practices to make sure every farm that we source coffee from is following cafe practices and cafe-practice certified. So we're over 90%. We think in the next two or three years our goal is to get to 100% basically ethically sourced coffee and we think that's best in class, as good as you can get.

We build farmer support centers in countries all around the world where we put agronomists on the ground. And their job isn't to further Starbucks' coffee supply chain; their job is to further the coffee supply chain broadly. So we share agronomy capabilities, we share learnings. On our coffee farm in Costa Rica we're doing things around planting and cultivating more drought-resistant, disease-resistant strains. Then as we develop those plants, we share them with everyone.

Again, whether folks produce coffee for Starbucks or not, for us it doesn't really matter. It's about developing sustainable producibility.

We're always looking at additional countries where we can add those farmer support centers and put in some of the best coffee knowledge in the world to teach farmers how to do things better. And it's all about driving that production. But in the right way with the right level of fertilizing, the right level of water, understanding when to replace plants. And just having those good basics around agronomy that we know so deeply about. But it takes a while, as we come into a country, to spread that knowledge.

A - Joe Buckley {BIO 1491816 <GO>}

Scott, Charlie, thank you very much. Excellent discussion.

A - Scott Maw {BIO 18637895 <GO>}

Thank you.