

# JPMorgan Gaming, Lodging, Restaurant and Leisure Management Access Forum

## Company Participants

- Scott Harlan Maw, Executive VP, CFO & Principal Accounting Officer

## Other Participants

- John William Ivankoe, Senior Restaurant Analyst, JP Morgan Chase & Co, Research Division

## Presentation

### John William Ivankoe {BIO 1556651 <GO>}

Good morning, everyone. It's John Ivankoe from JPMorgan, restaurant analyst here. It's certainly a pleasure to be headlining this event. And starting off Friday morning for us, the Starbucks Corporation.

With the company today is their EVP and CFO, Scott Maw. Also, joining them are their VP of Investor Relations, Tom Shaw; and Director of Investor Relations, Durga Doraisamy.

So welcome all. Thank you. So much for coming.

## Questions And Answers

### Q - John William Ivankoe {BIO 1556651 <GO>}

And we'd really like to talk about a number of different, I think, very topical initiatives for the company. And I think what's very interesting is continued growth of My Starbucks Rewards members and continued conversion of non-MSR members into active MSR members. And just the overall opportunity that you have and why you're excited about converting some of the 75 million customers that you have to the 15 million active My Starbucks Reward customers that you have.

### A - Scott Harlan Maw {BIO 18637895 <GO>}

Yes. Great question. First of all. Good morning, everyone. And thanks for having us, John. What I would say, is what we've driven over the past several years is significant growth. And over the last couple of years, almost all of our same-store sales growth from those customers that we have digital relationships with. And those are in our Starbucks Rewards program. And last quarter, those grew, I think, at 11%, a little over 1 million that we added. They're growing their spending rate somewhere between

mid; to high single digit. So you're getting both a revenue per customer growth and a number of customer growth. And I think that continues to be a big part of our growth as we look over the next year or 2 and beyond just because if you think about where we are in personalization, most of that growth is coming from personalization. But we've really only been capturing spend data and learning about spend data for a couple of years now. So we're pretty early on in the optimization of that process.

And we -- so we set a target out there sort of be in that mid-single-digit, hopefully, every quarter on spend growth and at least double-digit on number of member growth. And we've got a number of things that we're doing to bring customers in. And we feel really good about that as really a long-term growth driver. What's a little bit new and we've been talking about recently. And people have been asking about recently, is we've got 75 million people coming through our doors each month, 15 million in the rewards program. What about that other 60 million? We know you'll convert 1 million or 2 million every year into Starbucks Rewards. But what can you do beyond that?

So we've talked about -- and the big reason people don't join the rewards program is twofold. Number one, they don't know about the benefits of the program. We've done a lot of customer work on this. So they don't understand that when they engage with Starbucks and they bring their spend through the program, they basically get a 7% to 8% discount rate. That's one of the best loyalty programs out there. I'm obviously a numbers guy. So I know what credit cards do and what airlines do, hotels. And that 7% to 8% rate is really a big incentive. We can offer that because of the nature of preloading a card, because of the nature of our product and the margin that we have, because of the frequency of customers, because of the incrementality we've been driving with one-to-one personalization.

And so we've got to find a way to continue to get people to know about the program more. We're doing more things in store. We're doing more things as we can with digital marketing. But the real opportunity -- and then, the second reason is they don't want to preload a card. So one of the reasons that program is so, as you know. So beneficial for customers, is they preload a card, which has all sorts of benefits. Psychological benefits, that they know they have money loaded and banks and companies have been talking for years about when you put your money with someone and people know they prepaid it, you use that more often. And we see that. There's the benefit we get from flow, load or interchange and all that stuff. So that's the core program. But we know those 2 facts are hurdles for customers.

And so what we're starting to do is, for the first time, capture digital relationships so that we can use digital marketing assets, including personalization at the end of the day, to get non-Starbucks Rewards members or we like to say customers outside of the rewards program just so it's a positive. So what are those things? So I mentioned 3 things recently. 2 of them are either running or planned. And one of them we're debating and could come.

The first one is opening up Mobile Order & Pay to everyone. So it's long been a bit of a frustration for customers that don't want to join a rewards program or unaware that they can't order ahead. Starting, we think, by the end of March now, we'll be fully rolled out where everyone that downloads the app will be able to use Mobile Order & Pay. So we sort of opened up that channel. And it is a channel like drive-through or POS to all customers. There's no friction of having to be in the rewards program. So as we do that, obviously, we have the ability to capture their email address, to capture mobile phone information. And begin to market to them directly.

The second thing that we've done is we are doubling down on, you mentioned this, converting lapsed members. So we have 15 million, 90-day active members, pretty narrow active window. I think it's the right thing. But we have millions of what we call lapsed active or inactive members that are 91-plus days. And we've been marketing to those folks. And they've been a source of growth in the Starbucks Reward program, sort of reigniting them that Matt Ryan and the team have a number of things. And we're going to reach a little bit more on the offers that we give to them because we've got the math to show that it pays off to get them to come from inactive and back into active. So those are the first 2 things.

Then, the one that we're talking about, I'll call it, we're researching, although it's a little more than researching, is we call Wi-Fi sign up in our store. So you come into our stores, you give us your email, then every time you come in, you're automatically connected to Wi-Fi. You don't have to accept and connect. It's convenient for customers and it allows us to have a chance, again, to email market. You add all those things up. And we said on the most recent call, we think we can have several million of these non-SR digital relationships. It's not going to be a revenue driver this year. As we get into and through next year, we'll be able to start understanding what their spend patterns are. And then, start marketing to them directly. And they should, as we get through '19 and beyond, start to contribute to comps. And as you know, to date, that group really is not, is 0, right, in the revenue stream from personalization with that group today.

**Q - John William Ivankoe** {BIO 1556651 <GO>}

And so do you view the Chase opportunity separately from this?

**A - Scott Harlan Maw** {BIO 18637895 <GO>}

Yes. When I think about Chase, it's really in that core program. It's a way to capture more Starbucks Rewards program and drive increased activity. And what we've done with Chase, there are sort of 3 pieces to the agreement. There's obviously an interchange agreement, which is beneficial as with every credit card that's done with any retailer. And by the way, the debit card is unique just because debit card rewards are so unusual. So that piece by itself will drive increased profitability. Chase buys stars from us. We think we have a chance to market to those customers. We think the fact that people earn stars when they spend, that will drive more customers into our stores. So there's some comp impact.

The interchange piece in the first few years is actually bigger than the comp piece, just given the size of our interchange spend. Then, the third piece is really around

building out the infrastructure to do partnerships. So you'll remember Spotify, Lyft, The New York Times. Those were wonderful partnerships. It's sort of small. But even doing those it was highly manual tracking those partnerships. So this is now fully automated. It took us a little longer than we thought. When I say a little longer, we're almost 1.5 years past our original date, to be honest. But the big reason of that is, we've built that out. We now have the ability for customers to earn stars outside of our stores at different rates, burn at different rates, all the way from how we market integrated marketing capabilities all the way back through to something as basic as the accounting system. So as we look at other partnerships. And there will be more, we now have the engine to run those on.

**Q - John William Ivankoe** {BIO 1556651 <GO>}

So obviously, driving comps is actually increasing the ability of your stores to serve more customers. 2 different things. One, do you have continued ability to drive the morning business through a Mobile Order & Pay improvement? I mean, I know that was an initiative over the past year. I mean, is there a Part 2 to that, perhaps, that you can talk about? Then, secondly, maybe a little bit separately from throughput if you want to look at this holistically or not, is the afternoon business. And as you get data on a weekly basis, if you're understanding the afternoon weakness better in terms of what the causes are. And by definition, what some of the solutions may be.

**A - Scott Harlan Maw** {BIO 18637895 <GO>}

Yes. I'll take those in order. If you look broadly at throughput. And we'll start with that peak. But I want to talk a little bit about what we've done throughout all dayparts recently. So you'll remember, a year ago, we struggled with throughput at peak, particularly in very high-volume MOP stores. And so what we did is, we created specific roles and trained those roles that, at peak, all they did was support MOP. So before, maybe there were 7 or 8 partners working at peak, 3 or 4 of them might be doing some portion of MOP, fulfilling the orders, consolidating orders, doing handoffs.

What we did in 1,500 stores is we -- you trained either 1 or 2 roles if, in some stores, we trained run role just to do the consolidation. And then, partners would share the calling and handoff. But in the really high-volume stores, we train someone just to consolidate orders from the cold case and the oven and the Espresso machine together and get the ticket ready for it to go and one partner to call. And because we could make that -- and it's not 4 hours a day, right? It's a couple of hours a day in some stores. In some stores, it's 1 hour a day.

Whenever that peak is, it allowed us to connect to customers. It was the same person in the store every morning a lot of times. So you get to know your customer. And it significantly improved the customer benefit. Fewer lost items because the orders were consolidated by the same person and in order. And so that -- within about three months, in those 1,500 busiest stores, we saw comps turn. And over the last 3 quarters, they've actually been improving comps faster than the average. And so -- so that's what we've done.

To your question, is there more that we can do? So about 3 weeks ago, we rolled out a national update to how we -- how our partners work. We call it Deployment 2.0, which is a terribly boring name. But that's what we call it. And really, it's based upon what's happening in the store, how many people are deployed doing what. It's been about five years since we've done that. And the way we were doing it before, it was absolutely weighted for how many transactions you have, of course. The more transaction you have, the more complex the transactions you have, the more labor you earn. But what it wasn't really weighted for specifically was the product mix of those transactions, deeply product mix store-by-store. And even with those transactions, it was sort of a lot more on average by store type as opposed to store-specific.

So what we have now is each and every store for each and every daypart has not only how many people they should have staffed, which is what we did before. But where they should be. And so I'll just rattle off a couple of stats here. If you go back five years ago, cold beverages as a % of total beverage revenue in our Starbucks stores was in the mid-30%, I think it's 36%, 37%. You roll forward five years, cold beverages are now over 50% of beverage sales. And in many stores, they've doubled, right? You've gone from 30 to 60 or something like that. Warmed breakfast sandwiches have doubled in many stores, yet the play is based upon an average number of transactions and the deployment is based upon average from five years ago.

So now in stores, they have a high mix of cold. We'll have 2 partners standing back to back, one at the Espresso machine and one at the cold beverage station working on those concurrently. Previously, you might have someone at the Espresso machine turning around and trying to keep the cold beverages. And throughput suffers from that. So that impacts and influences everything. It's 3 weeks in. The partner response has been really strong. I'm copied on a lot of that. And so we think we're on to something. We think we're off to a good start. And even if the partners are just happy and nothing else happens, it's going to be a good thing. But I think that is also part of what will help in the afternoon. So if I could pivot to that.

So in the afternoon. And just to give you guys a little bit of math, we're comping positively in the morning daypart last quarter. Lunch was flattish and the afternoon...

**Q - John William Ivankoe** {BIO 1556651 <GO>}

And this is traffic?

**A - Scott Harlan Maw** {BIO 18637895 <GO>}

This is traffic. Yes. Yes. And total comp, just because given where the comp that we reported was a 2%. Lunch was flattish. And the afternoon was quite negative. When you think about that afternoon and evening daypart, it's a pretty small daypart. And so you can think about the size of negative comps that we're seeing there. And what we're seeing in the afternoon, some of that was holiday. But what we're seeing in the afternoon is an opportunity to make sure our partners are focused on the customer first. It's not that they've taken their eye completely off the customer. But there are so many things going on in that afternoon daypart. Again, sort of driven by us around

just cleaning and training and restocking. We just want to make sure that what -- while we're doing that, we're keeping an eye on the customer. And I think with this new deployment, that helps free that up.

Then, in the afternoon, there's a big opportunity, we think, around product. So as we move particularly through and into the warmer months, Nitro will be a big part of that. Cold Brew broadly. But Nitro. We've got lots of things planned around iced teas that have done well for us. So we think that afternoon daypart, we have the right products. The challenge, as you know, has been Frappuccino has been declining faster than those new products have been growing. It's not that those new products haven't been working. It's just the net of that given the Frappuccino decline has been slightly negative.

Then, digital becomes a big opportunity for us, both lighting up that new 1 million member that we have coming in. But also, if you watch your offers carefully a lot of the sprints that we're doing. And the star dashes and the gamification are pointed at the afternoon. So come in, in the afternoon and bring a friend and do this or come in, in the afternoon over the next two days and get 100 stars. So all of those things are pointed at the afternoon. We think we can start to turn that pretty negative daypart, not -- probably not positive this year. But even if we can get it to be slightly negative, that'll help comps a ton.

**Q - John William Ivankoe** {BIO 1556651 <GO>}

And so let's discuss Frappuccino. I mean, have you talked about what percentage of your sales it is, for example, in the summer months? Excuse me if I don't remember.

**A - Scott Harlan Maw** {BIO 18637895 <GO>}

Yes. I think we've talked about, for the full year, it's somewhere in the mid-teens of our sales mix. And so it's a meaningful category for us.

**Q - John William Ivankoe** {BIO 1556651 <GO>}

Right. So -- and presumably, more than that in the summer. So stopping Frappuccino Happy Hour, I mean, is it your belief, I mean, you no longer have to discount to someone that was going to buy the Frappuccino anyway, that the discount wasn't actually driving increased traffic. It was just allowing people to spend less that would buy it. So why isn't this a risk for the business? And I guess, like how much of a -- how much anxiety is there in the kind of pulling of promotion that you obviously used to put a decent amount of faith in?

**A - Scott Harlan Maw** {BIO 18637895 <GO>}

Right. So what's happened with Frappuccino -- you got it exactly right. What's happened with Frappuccino over the last two years Happy Hour is the halo that we get after the promotion has gone away. So what used to happen is, we do Frappuccino Happy Hour. We'd sell a ton of Frappuccino, we'd comp well in that time period. But what would happen is, people would continue to come in and buy Frappuccinos and other beverages in the afternoon at a higher rate throughout our Third Quarter. And so that was really where we paid it back. We didn't actually pay it

back during the promo. It was wonderful. And -- but it was all of the impact we have because we were top of mind with people after. That softness is what we've seen in the last two years. And so financially, bottom line standpoint, it really hasn't been worth it over the last two years and wouldn't be worth it this year.

So but your question is on top line, right? So what we're trying to do this year is sort of reinvent Happy Hour. And there'll be more details to come. But basically, the gist of it is using our digital assets to light up Frappuccino Happy Hour for those people that we think it's truly incremental. Basically count on the fact that the halo's probably not going to come and try to get real incrementality while we're running Happy Hour. And we've got another -- a number of other products and promotions during that time frame. We think we can close some of the gap.

Then, the other thing, I'd just remind you, while Frappuccino Happy Hour early in the quarter was positive, the back half of the Third Quarter last year was pretty tough. And so when you think about the comparisons for the full quarter, we get -- we feel comfortable that we can do at least a 3% as we get through the back half of the year. So it's all those things. The fact that, yes, we have a little bit bigger comparison. It's not a big P&L driver. But we've got a number of things around cold beverages, probably some specific Frappuccino Happy Hour offers to offset that during Happy Hour. Then, we think good momentum as we move through the rest of the quarter to comp strongly. And the thought is get to a 3% for the year.

**Q - John William Ivankoe** {BIO 1556651 <GO>}

So -- let me take that then. Do at least a 3% comp in the back half of the year, December was 1%. I mean, I think you've commented that January was 1%. A couple of different things here. I mean, let's isolate January between what you think the impact of the Starbucks Card gift was. Let's isolate the lobby and like the experience and when that might be lapped. I mean, if it's possible to isolate maybe some throughput initiatives, I mean, the deployment 2.0 that hadn't been put in yet.

So in other words, why is January an anomaly? Then, secondly, we'll come back and just understand holiday. I mean, is holiday something that it's always going to be the low quarter and that's just something that we need to accept and expect? Or does holiday '18 -- I'm sorry, to be pressing us in now to fiscal '19, is there a reason to believe that we can then take a December quarter back to trend?

**A - Scott Harlan Maw** {BIO 18637895 <GO>}

Yes, let's break that down a little because I think it's a fair question that's on people's mind. So if you think about the -- our First Quarter, the holiday quarter, first 6 weeks or so, half the quarter, we had strong momentum and really a continuation of the 3% comps or so we've done for a while. So that was in place when we went into holiday. Pretty much right when we went into holiday, we saw the impact that you're talking about. And for the back half for the quarter, you can just do the math. It was about a 1 comp. What we said is January is similar just without completely backing myself into a corner. But obviously, you're in the ballpark. So January was soft as well and looked quite a bit like that back half of the holiday period. And it was actually some of the same drivers.

So what we saw in January, 2 things in particular, was the continuation of the softness in lobby. And again, I think that was ongoing from holiday as we typically get a little bit of carryforward into January as we move through some of our final merch. Then, the second thing is, we didn't get the gift card tailwind. And so gift cards weren't negative year-over-year. But they were flat. And we typically get a nice tailwind in comps as we get into January. And that tailwind actually was a little bit of a headwind. Small amount. But it was meaningful. So as we get through January, those 2 things almost, by definition, should abate. There's still some gift cards coming in. So it's not 0. But it's not a huge number. And the things that you -- we talked about, which is this change in deployment, some of the product things we are doing like Blonde Espresso, which is off to a great start. And all the things we're doing in digital, we think that's enough to move us back up to get up towards that 3% run rate as we move through the rest of the year. And that's what gives us confidence to get to 3% for the year.

I think if January -- sorry, John, maybe just -- I think if the drivers in January were so different than what we saw in the holiday or not related to holiday, I think it would be harder to sort of understand what's going to happen. So it's a little bit of what's not there as we move forward. But it's also the things that we have momentum around.

**Q - John William Ivankoe** {BIO 1556651 <GO>}

So can we talk about holiday...

**A - Scott Harlan Maw** {BIO 18637895 <GO>}

2018, sorry.

**Q - John William Ivankoe** {BIO 1556651 <GO>}

Yes. First quarter '19...

**A - Scott Harlan Maw** {BIO 18637895 <GO>}

I think, first of all, our lobby will be entirely different. And so even if we won't have the same negative comp impact, I'm not sure if it will be positive or not, just because you still have a year-over-year decrease in the number of SKUs. But I promise you, it will be more profitable. Fewer mark-outs, fewer BOGOs, fewer write-offs. So all the things that have hurt us in the lobby before. So from a top line standpoint, my guess is there's opportunity, maybe, to go a little bit better there in lobby. But from a bottom line standpoint, it'll absolutely be better. As we get into holiday beverages, what I think we've learned over the last year or 2 is we're going to really have to go deep around digital at holidays. So not only in our own channels, email and in app. But also in our social media channels and really try to make sure that we're doing everything we can to reach our customers digitally. And that is what's driving our comps. So I feel like that kind of offsets some of these headwinds that we've seen.

**Q - John William Ivankoe** {BIO 1556651 <GO>}

Okay. So annoying question, Unicorn Frappuccino was how big of a driver in the last year? I mean have you begun to kind of talk about that and prepare us? And is there



an encore for it?

**A - Scott Harlan Maw** {BIO 18637895 <GO>}

Yes. So it was -- I mean, it was a pretty big driver in the month of April. And we've got a number of things teed up, which I can't quite announce yet. I think watch what Kevin talks about in the Annual Shareholders' Meeting. And then obviously, in the earnings, we'll give you an update.

Look, we think we can offset that comp, over the course of not only the month of April. But over the course of the quarter. We'll see how we do. It's a relatively big number. But I don't think we're terribly nervous about it, particularly if you take a little bit longer-term view. It was a wonderful product. And we've got some other things planned that, I think, will be pretty cool as well.

**Q - John William Ivankoe** {BIO 1556651 <GO>}

I never even laid eyes on one.

**A - Scott Harlan Maw** {BIO 18637895 <GO>}

I hadn't either. I mean, I was in a meeting with John Culver. I hadn't laid eyes on one. I said that. And all of sudden, he Mobile Ordered and Paid one. And someone brought in from our store. And I'm like, oh, that's what it is. It's actually pretty good. It's just a lot.

**Q - John William Ivankoe** {BIO 1556651 <GO>}

Yes. Well it was already gone by the time -- and I go every day. So I don't even know what happens. Okay. So...

**A - Scott Harlan Maw** {BIO 18637895 <GO>}

We got a number of things planned, I think, that will offset some of that.

**Q - John William Ivankoe** {BIO 1556651 <GO>}

So Deployment 2.0. I mean, we've been focusing on the throughput side. What about the cost side? So let's take cost. And then, just kind of push into that part of the equation. Obviously, U.S. margins were not what you wanted them to be in fiscal '17. They weren't what you wanted them to be in the First Quarter of '18. So when can we begin to at least stabilize that? And what does it take to grow America's margins again?

**A - Scott Harlan Maw** {BIO 18637895 <GO>}

Yes. So if you go to the time before the tax investments came in. So go back to guidance, basically. And where we guided. What we said is the first half is going to be challenged. In the back half, we should start to see improved margin, then margin expansion. And so if you adjust for the tax impact, we're still in that ballpark for the U.S. I think as we get through the Third Quarter, into the Fourth Quarter, we can see a little bit of margin expansion. It's not going to be anything like you saw in 2014 and

2015. But a little bit margin expansion, which given the investments, I think, is just fine.

And so what's driving that I think is your question. We have our normal work around, it's not easy. But it has been something we've had for a while around cost of goods sold. And that's looking good. And I think a couple of hundred million is our target this year. And we're on track to get the vast majority of that. This year, we launched 2 new initiatives. And Roz has really been leading in driving these things. And her background has been wonderful to partner with.

So labor savings and waste savings. In both of those, we're sort of three months in. In the First Quarter, running on track. And there are significant savings there. And you know about this. But the big opportunity there is taking a look at our stores and de-averaging them. And looking at those stores that on the surface of it, we can analyze this from Seattle. On the surface of it, it looks like they have too little waste and -- or too little labor. And what we want to do is we want to add in product. And we want to add in labor to drive sales.

On the flip, we call that the green tail. On the red tail of distribution, it's too much, right? So we want to manage that cost. And so we're off to a really good start there. There's Lean principles that we're deploying. There's lots of analytics that we're getting into store-by-store, working with district managers, working with store managers. But the opportunity is significant. And that builds obviously, is back-end loaded, right, as we get that pipeline built. And we feel like if we can execute on all that, we can get back to margin growth, excluding those tax investments.

And if you're thinking, what about including the tax investments? We'll lap the majority of that as we get into the Third Quarter of next year. So most of the wage increases that we announced will go in place in April.

**Q - John William Ivankoe** {BIO 1556651 <GO>}

Okay. So a lot of companies have been here in the last -- yesterday, I suppose, that have talked about putting technology in to reduce labor hours, efficiency, effectiveness and really being driven not as a nice to have, as a need to have, especially in high-wage markets such as your home state and a number of other markets that you do business in. So to what extent can technology -- can you enter the tipping point where technology and how consumers use the brand or potentially new things to (inaudible) what have you, to begin -- that you'll to start to reduce the number of efficiency and effectiveness in terms of store-level labor expenses?

**A - Scott Harlan Maw** {BIO 18637895 <GO>}

Yes, I think that one of the things that we've done around, for example, supply chain. And this impacts the store because our managers are obviously ordering and stocking inventory. So we're continuing to look for automation opportunities, both in our manufacturing and distribution centers, robotics and some of our distribution centers to improve the efficiency and accuracy of orders. So that we can get managers less and less involved in their own store orders. So automated ordering is something that we're looking at. So literally, you still have a chance to look at your

order. But you're not filling out an order every day. It just comes. And it's highly accurate because of the automation of the supply chain. So we're well into that.

Within stores, we're looking all the time, although with lean techniques, we're getting far smarter about what is time and motion around Espresso machines and how do we get our Espresso machines positioned right in the stores? How many do we need? We're starting to work upstream. Matter of fact, we got a new Espresso machine in test right now in a couple of our stores. We're working upstream with our manufacturer to make those more not only quicker in the way that they deliver Espresso. But also enable -- Bluetooth; and Wi-Fi-enabled so that we constantly are looking at the efficiency of those machines, what the grind looks like and taking all that work off our partners. So they're not adjusting the grind 3 or 4 times a day, it's happening automatically. So all of that is helping within the stores.

Then, when I talk about this deployment work, again, it's really using the analytics to figure out where to use people without having more folks. And so as you know, if people have more transactions, they earn labor. But most of the Deployment 2.0, probably 95% plus of the stores, it's simply redeployment with better analytics. So all of that should help the store experience. And the goal -- the way I think about it, John, the goal is all of those non value-added activities that don't touch the customer touch the product. We want to simplify those greatly. We won't be automating how we make Espresso beverages. I know you're not saying that. We won't be automating how we make breakfast sandwiches. We've looked at automating things, like, could we automate some of the brewing that we do? But anything that really is about that Starbucks experience, it will always be handcrafted.

**Q - John William Ivankoe** {BIO 1556651 <GO>}

Which may free you up to do more things on the premium side. I mean, if you have things like drip, for example, that's automated would be fine, especially if there's more of a handcrafted element in terms of Reserve bars within Starbucks stores. And that's something that a couple of years ago, I thought there was going to be a relatively big conversion opportunity within the traditional Starbucks U.S. store base in terms of putting in Reserve bars what have you. But it doesn't sound like that that's a big opportunity at least in the short term. So do you have an ability to put customer-facing attributes within the Starbucks store of, hey this drives like additional traffic or drives additional ticket in term -- from a capital perspective?

**A - Scott Harlan Maw** {BIO 18637895 <GO>}

Yes -- the answer is yes. And I think your intuition on the number of new Starbucks Reserve bars, let's call them, versus converted, if we get to 20% of the stores that have Starbucks Reserve bars, there'll be a meaningful number of those that are conversion. If I was betting, I would say it would be the majority just as we go through renovations and look for those opportunities and even some of the ones that we're testing in the U.S., they're conversion. So I think your intuition is right.

And when we talk about store returns. And I talked about this a fair bit yesterday, most of our new stores are drive-throughs. But not all of them. And so we've got 80% drive-throughs, 20% more in urban markets. Those 20% stores, they skew the

way you're talking about. Not all those new stores are Reserve bars. But many of them are Reserve forward. They're more about third place experiential retail, things that we've been doing for decades. And those stores still have really good returns. But they're not as high as a drive-through. But for us, that's absolutely critical. We cannot back away from the premium experience and write the expression of the brand. So we'll continue to invest in those stores, get a great return, maybe a little bit lower than what you see in drive-throughs, while we drive convenience and transactions through the drive-through stores.

And the last thing I'll say is if, you really want to see this, at a little bit more at scale because we only have a couple of dozen Reserve bars in the U.S., you can go to China, where they have a lot more. Whether they're Reserve bars or what tag we put on them, Reserve Forward stores, Pour Over, Slow Bars, Clover, all the things -- ways to enjoy coffee at the premium end.

**Q - John William Ivankoe** {BIO 1556651 <GO>}

Thank you. Is Mercato the food solution? I mean, as it currently stands, I mean, the packaging is it's -- austere might sound like a negative word. But minimal, it's fairly high priced. Obviously, it's much harder to manage inventory coming in, coming out of the store every single day. I mean, is this the permanent solution that you see that's right for the country? Or is that just going to still going to be done on a market-specific basis?

**A - Scott Harlan Maw** {BIO 18637895 <GO>}

Yes, I think we're still sorting that out. So we're in 2 markets. We'll roll 6 more markets before the end of the year. And what I've said about Mercato is when we roll it out, there's probably 30 or 40 SKUs. I should know the exact number. Let's just say there's 30 SKUs. There's a couple of dozens SKUs, right, okay, that come out under the Mercato banner. And some of those SKUs do really, really well. And some of those SKUs do good. And what we were trying to learn is do all of those SKUs go into every store across the U.S.? It probably not, right, just from a supply chain efficiency standpoint. Do some of those SKUs go to every store in the U.S.? Perhaps. A few champion SKUs. So all of those SKUs go into all the stores along the coast? Maybe. That's what we have to figure out. We figured out cost of goods sold. We figured out the delivery costs. But we're still working on what's the demand equation, what's the value equation and what's the waste solution. I believe that there will be some number of fresh -- fresher SKUs in our stores that come through Mercato. The question is just scale. And I think that's the nature of your question.

But I just want to go beyond food. Food growth over the next few years is not predicated on Mercato. A little -- I've gotten that question a little bit from folks. I think that's upside for us in the afternoon. It's upside for us around fresh. But if you look at today, Sous Vide Egg Bites, our new innovation, they're driving a ton of growth. We've got the up level than we did on Bistro Boxes with everything being protein forward. We've got the upleveling we've done on some breakfast sandwiches. And those are driving 2 points of comp. So food comp and innovation is quite healthy. But if I had 1 point of beverage comp, we'd be having a different discussion.

**Q - John William Ivankoe** {BIO 1556651 <GO>}

So cannibalization, obviously, in the U.S., especially given your rate of store growth and relatively -- depending on the quarter, relatively flattish same-store traffic, I mean, how are you measuring it? And have you seen -- I don't think that you're seeing it on a national basis. I don't know if you're seeing it on a local basis. I mean, have you seen cannibalization on a local basis, where you have materially taken capital out of one market. And said listen, this is a higher return to where you were -- your cannibalization real time data, for example, is robust?

**A - Scott Harlan Maw** {BIO 18637895 <GO>}

Yes, I'll use the word sales transfer. If you look at sales transfer, we track it -- there's sensitivity around the other word. So we track it store-by-store. And you're absolutely right, John. So we see sales transfer when we open a store. We plan for it, actually. So I did a couple of slides yesterday. And I used the store in Fort Collins, Colorado, where we had a really profitable store in a shopping center in Fort Collins that was doing, I think, \$1.5 million, if I remember correctly, about 700 AUVs. We opened a drive-through, big, beautiful drive-through, a couple of hundred -- I'm sorry, a couple of miles away. And it did \$2.5 million or something like that of sales. And it's doing 1,000 transactions. And what happened in that existing store within the first year. And again we planned for it, lost 100 AUVs, right? Then, what happens is it comes back into the comp base in comps. And so the math around the new stores is there's going to be cannibalization.

And what we do is we add all of that cannibalization that we can track in impacted stores, that negative number on a weighted basis. And we take all the positive lift we get from comps in years 2 through 5 after we open a store, it's in the comp base. We take the positive and the negative on a weighted basis. We put them together. And it's basically 0. Sometimes it's a little bit positive. Sometimes it's a little bit negative. But it is basically 0% impact on comps. And what you're left with is. And the other picture I showed is, you're left with the incremental cash flow that's come into that new store. And it's a hugely -- like some huge percentage. I can't give the actual percentage. But it's the vast majority is incremental comps. And so when you do the IRR on that, given our AUVs and given our relatively lower cost investment. And given the margin on our product, it's big incremental benefit from a cash flow standpoint.

And the last thing I'd just say is, I'd just remind everyone the licensed stores that we opened, they're about half of the 750 stores we opened in the U.S., they have very different characteristics than the company-owned stores. They tend to be in captive locations. It's not that there's 0 cannibalization. By the way, we track those too. And we model cannibalization on licensed stores as well. But it's just a different type of impact. I said the word I said we'd never use. We model sales transfer and license stores as well, it's just a different type of impact.

**Q - John William Ivankoe** {BIO 1556651 <GO>}

Last question. We are at -- 80% of your stores are drive-through. We don't talk about significant drive-through throughput. I mean, this is kind of the ultimate single

queue, the faster you can be, the more people you're going to serve.

**A - Scott Harlan Maw** {BIO 18637895 <GO>}

Right. So you want to talk about -- that is the place where Lean is helping us the most today. So we are doing time and motion studies. We are doing things where we go in and look at the highest throughput drive-through stores because in the drive-through, we have so much telemetry about what's ordering and how everything closes out, right? Because unlike at the POS where we don't yet have the DOM rolled out everywhere, we're not closing out every order. In the drive-through, we close out every order. So we know exactly how long each and every product takes to make. So we find the best drive-throughs, again, using distribution. We find the best drive-throughs. We do time and motion studies. And we're starting to train that into all of our drive-throughs.

**Q - John William Ivankoe** {BIO 1556651 <GO>}

And Mobile Order & Pay is better integrated in the drive-throughs. I mean, that's -- I mean, in terms of when the customer comes into the queue, that the product is being made at the right time. I mean, that's always a challenge. Are you...

**A - Scott Harlan Maw** {BIO 18637895 <GO>}

We're getting better at that. And one of the things that we've been talking about is we've gone to channel production in some of our busiest Mobile Order & Pay store. And all -- what channel production is, it's important is, we dedicate an Espresso machine and a POS to Mobile Order & Pay. And we dedicate an Espresso machine and a POS to in-store traffic. And that allows us to move the in-store experience faster. So people perceive that things are going faster rather than, in some stores today, it's just in the order it comes in. And we didn't get a chance to talk about China.

**Q - John William Ivankoe** {BIO 1556651 <GO>}

We didn't.

**A - Scott Harlan Maw** {BIO 18637895 <GO>}

So please, can I just say one thing about China? Probably the single -- John asked me this before, probably the single underestimated -- single most underestimated opportunity within Starbucks. Please come to China in May. It's going to blow your mind, it's an amazing business.

**Q - John William Ivankoe** {BIO 1556651 <GO>}

The last conference call that you did, well, I think that was January 31, was certainly very helpful on China. (inaudible)

**A - Scott Harlan Maw** {BIO 18637895 <GO>}

Yes. Yes. I know. (inaudible)

**Q - John William Ivankoe** {BIO 1556651 <GO>}

It's all good. It's very top of mind. But 30 minutes goes by very fast.

**A - Scott Harlan Maw** {BIO 18637895 <GO>}

Oh, I get it. Thank you, John. Yes. Thank you.

**Q - John William Ivankoe** {BIO 1556651 <GO>}

Thank you.

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