

Starbucks Corp China Modeling Conference Call

Company Participants

- Belinda Wong, CEO of Starbucks China
- John Culver, Group President of International and Channels Development
- Scott Harlan Maw, Executive VP, CFO and Principal Accounting Officer
- Thomas Shaw, VP, IR

Other Participants

- Andrew Marc Barish, Analyst, Jefferies LLC, Research Division
- Brett Saul Levy, Analyst, Deutsche Bank AG, Research Division
- David E. Tarantino, Analyst, Robert W. Baird & Co. Incorporated, Research Division
- Gregory Ryan Francfort, Analyst, BofA Merrill Lynch, Research Division
- Jason Taylor West, Analyst, CrÃ©dit Suisse AG, Research Division
- Jeffrey Andrew Bernstein, Analyst, Barclays PLC, Research Division
- John Stephenson Glass, Analyst, Morgan Stanley, Research Division
- John William Ivankoe, Analyst, JP Morgan Chase & Co, Research Division
- Karen Holthouse, Analyst, Goldman Sachs Group Inc., Research Division
- Matthew James DiFrisco, Analyst, Guggenheim Securities, LLC, Research Division
- Ronald John Hottovy, Analysis, Morningstar Inc., Research Division
- Sara Harkavy Senatore, Analyst, Sanford C. Bernstein & Co., LLC., Research Division
- William Everett Slabaugh, Analyst, Stephens Inc., Research Division

Presentation

Operator

Good afternoon. My name is Rob. And I will be your conference operator today. At this time, I would like to welcome everyone to the Starbucks Coffee Company's China Modeling Conference Call. (Operator Instructions) I will now turn the call over to Tom Shaw, Vice President, Investor Relations. Mr. Shaw, you may now begin your conference.

Thomas Shaw {BIO 15317835 <GO>}

Good afternoon. And thanks for joining us on today's China modeling call. Given the closure of the East China acquisition on December 31, 2017, we wanted to provide both a deeper overview of the opportunities we see in China as well as the expected impact to Starbucks' financial statements to assist you with your modeling of our business.

With our First Quarter results covered last Thursday, this call will be focused on these 2 items. Prepared remarks today will be led by Belinda Wong, EVP and CEO, Starbucks China, who just celebrated her 18th year as a Starbucks partner -- and Scott Maw, CFO. Joining us for Q&A, we'll also have John Culver, Group President, International and Channels. To help facilitate the conversation, we have posted a document on our website at investor.starbucks.com that summarizes the accounting treatment of transitioning from the East China joint venture structure to one that is company owned in fiscal 2018.

Before handing the call to Belinda, I would remind you that this conference call includes forward-looking statements, which are subject to various risks and uncertainties that could cause our actual results to differ materially from these statements. Any such statement should be considered in conjunction with cautionary statements in our earnings release and risk factor discussions in our filings with the SEC, including our last annual report on Form 10-K. Starbucks assumes no obligation to updating these forward-looking statements or information.

Please refer to our website to find the reconciliation of non-GAAP financial measures referenced in today's call with their most directly comparable GAAP measures. This conference call is being webcast. And an archive of the webcast will be available on our website until Friday, March 2, 2018.

I will now turn the call over to Belinda.

Belinda Wong {BIO 17337899 <GO>}

Thank you, Tom. Good afternoon, everyone. I'm very excited to be here today to talk about the company's fastest growing and most strategic market in the world: China. Starbucks pioneered China's specialty coffee market 19 years ago by introducing a unique experience and serving the highest quality coffee to our Chinese customers. Fast forward to today. And Starbucks is one of the most recognized and respected brands across the country.

Throughout our 19-year history in China, Starbucks has been building a different kind of company, one that has earned the love and respect of our Chinese customers and one that has earned the love and respect of our Chinese partners through our culture and the values we have built. Our success in China has been the direct result of our focus on our disciplined growth and the deep respect we have for the Chinese heritage and values. It is with these same principles that we'll continue to grow in China for many years to come.

Let me put into context the China market and the tremendous opportunities we have in front of us. China is projected to take over -- to overtake the U.S. to become the world's largest economy by 2030. In 2016, China actually already surpassed the U.S. in consumer spending. At the core of this economic change and social transformation has been China's middle class, the largest middle class population in the world. Over the next five years, another 300 million Chinese people will reach middle class status, doubling its size to a total of 600 million, almost 2x the entire population of the U.S. The rising middle class will for sure drive coffee consumption growth and further demand for Starbucks.

Now let me speak to our performance over the last several years. Just five years ago, there were only 700 stores across 53 cities. And fast forward to today, our store count has grown more than 4x. There are more than 3,100 stores across 139 cities. Our 45,000 partners proudly serve more than 6 million customers every week.

In the most recent quarter, we delivered a solid 6% comp growth, driven all by transactions. And as a matter of fact, we have achieved positive comps for 33 consecutive quarters. And all but 1 quarter achieved 5% or above. We also hit a new record of opening 188 new stores in Q1. We are ready to achieve our goal in opening more than 500 stores this fiscal year. All of these factors give me great confidence for the future of our business in China and is one of the key reasons we are now consolidating our ownership position to be a full company-operated market.

We are now at a point where we're moving forward with the integration of our East China business. Our East China region is comprised of 2 provinces: Jiangsu and Zhejiang as well as the City of Shanghai. This region represents 11% of China's total population and generates 22% of the entire country's GDP.

To put this into perspective, the 150 million people living in East China is equivalent to almost half of the U.S. population. Its GDP at $2.5 trillion is as large as the State of California or the entire country of India. Four of the top 10 most affluent cities in China are also from this region: Shanghai, of course, with the highest per capita income in the country as well as Hangzhou, Nanjing and Suzhou. Today, we have at least a 4 to 1 store advantage over our nearest competitor in this region.

In Shanghai, we operate more than 600 stores, the largest number of stores in any city around the world, yet there still is an opportunity to double down to reach more new customers and expand our market share. We're not even close. And I'm incredibly excited about the tremendous runway in front of us.

The size and scale of East China and having it integrated into a fully owned company-operated business will help us scale for the future, gain synergies and gain operational efficiencies in the business. Going forward, we will now have one local management team who will have the ability to strategically prioritize our investments, streamline decision-making and provide a full focus on delivering the growth aspirations we have across the entire country. We will also have the opportunity to fully integrate and up level our back-end infrastructure, which includes supply chain, IT, store development and design. And R&D. We see incredible opportunities to drive meaningful food and beverage innovation and to expand our digital footprint to improve the overall customer experience in our stores.

Shanghai is at the forefront of consumer trends that the rest of China is biased to emulate. This was behind the strategic decision to open the first international Roastery in Shanghai. Not only are we introducing new concepts such as Teavana stand-alone tea bar and Princi food, we are using the Roastery as an innovation lab for future beverages and new concepts across the country.

The young Chinese generation today seeks innovative digital and retail experiences. We now have a total of 6.2 million active My Starbucks Rewards members, almost half of the U.S. active members and with 1/5 of the store count. By end of Q1, we added almost 1 million active members, an impressive 17% year-on-year growth. Through our strategic relationships with Alibaba and Tencent, we have been able to attract and bring in new customers to the Starbucks Experience. Alipay and WeChat Pay, the most convenient and popular payment platforms in China, now account for over 60% of our total tender. These platforms combined with other cashless payment options in our stores account for 80% in cashless transactions.

Now that we have direct access in connection with these customers through our digital relationships, we can drive higher return on our digital investments, including existing programs like (inaudible) and future opportunities such as delivery. What I'm most excited about is the opportunity I see for our people, specifically around talent management and career development at a national level.

We have immediate access to the experienced partners in East China and can deploy the best partners in key markets to help drive our key priorities. We also see this as an opportunity to extend our innovative world-class benefits such as Bean Stock, the housing allowance subsidy for store partners and the critical illness insurance program for the parents of our partners. We will go into further detail on all of this as well as the progress we're making to achieve our China growth agenda.

I'd like to invite you all to join us this May in Shanghai at our first ever China Investor Day. As part of your visits, you will experience firsthand what has been at the center of our success: our people. What you'll see is not only the incredible passion and pride they have for working at Starbucks but also the way in which they bring the Starbucks Experience to life for our customers and each other every day. This truly is what is unique and different about Starbucks in China. And of course, you will also be able to experience our newest coffee wonderland, the Shanghai Roastery.

Let me close by saying I could not be more proud of what the China leadership team and our partners have accomplished over the past few years. With our customers and partners at the heart of everything we do, we'll continue to strengthen our lead in the market and along the way, share our success.

Thank you. And now I would like to hand it over to Scott.

Scott Harlan Maw {BIO 18637895 <GO>}

Thank you, Belinda. Good afternoon, everyone. And thank you for joining us on today's call. In the interest of preserving maximum time for Q&A, I'm going to avoid repeating a lot of information shared on last week's Q1 earnings call and instead proceed directly to highlighting certain existing financial metrics and introducing a few new metrics.

The East China business will be fully consolidated and reflected in our financial statements beginning in Q2 of fiscal '18. East China store comp sales will be reflected in our global comp store base beginning in Q2 of fiscal '19. From a modeling perspective, I'll note that under the joint venture structure existing prior to the acquisition, all royalties from and product sales to the East China JV were included in Starbucks net revenues with associated costs reflecting in COGS.

50% of the JV's profit was reflected on our income from equity investment line, accounting treatment that resulted in triple-digit operating margin from the East China JV as we reported approximately 50% of the profit but only a small portion of the revenue. As discussed last week, consolidating East China will result in a 4percentage point lift in our net revenues in fiscal 2018, adding over $1 billion on a pro forma run rate or an annualized basis.

Looking ahead and normalizing for the timing of the transaction, we expect CAP revenue growth in the mid-teens and China revenue growth north of 20% on a run rate basis in each of 2018 and 2019. This will translate into reported CAP revenues that will approach $5.5 billion fiscal 2019. In the aggregate, our Mainland China business is expected to drive a significant majority of CAP's revenue growth and approximately 1/4 of Starbucks' total revenue growth in each of 2018 and 2019, again, normalizing for the timing of the transaction and will comprise over 50% of total CAP reported revenue in 2019.

Comps from former East China JV stores have generally been very consistent with the numbers that Belinda shared earlier. East China comps came in somewhat below the company-operated store figure over the past two years as a result of the JV's more aggressive store growth strategy during that time. East China store growth has averaged nearly 40% over the last three years compared to under 25% in the rest of Mainland China. The success of this strategy is clear as we have taken significant coffee share in key markets such as Shanghai. Given the opportunities Belinda covered earlier regarding marketing, product development and other operational areas, we believe we can close some of this recent gap as we move into 2019 and beyond.

Let's move on to the profit impact of China on Starbucks and our CAP segment. As I stated on the earnings call, CAP comprised nearly 50% of non-GAAP operating income growth in 2017 and should comprise over 40% in 2018 and 2019 with Mainland China comprising a significant portion of this growth. Turning to margin, the impact of the acquisition is expected to be slightly negative to reported consolidated operating margin in 2018. At the segment level, the acquisition is expected to lower CAP operating margin moderately in 2018 on a non-GAAP basis. However, given the profit growth in Mainland China, we expect moderate margin expansion to resume once we fully lap the acquisition impact after Q1 2019.

Updating what I said on last week's call, we now project that CAP will have the highest retail segment operating margin within Starbucks by the end of 2019, if not earlier. We continue to expect the East China acquisition in conjunction with our other streamlining activities to be flat to slightly accretive to overall non-GAAP EPS in 2018 as I've shared on previous calls.

Specifically, East China will add 1 to 2 points of non-GAAP EPS growth in 2018 and the impact of the other activities, including the absence of our Tazo business. And the conversions of Taiwan and Singapore to licensed operations will largely offset this impact. I'll remind you that we expect a cumulative impact of these moves to become more meaningfully accretive to returns and EPS growth as we move into the back half of 2018 and into 2019.

Finally, besides being complementary pillars of future growth, our U.S. and China businesses are increasingly benefiting Starbucks and each other today. As Belinda mentioned, a good deal of the inspiration from our Reserve bars in the U.S. came from store and design innovation that has its roots with China. And China continues to meaningfully benefit from our U.S. R&D engine, including innovation around our Cold Brew platform and supply chain initiatives. We fully expect this collaboration to both continue and become increasingly valuable and accretive over time.

On a personal note, I'd like to share that in the process of immersing in the due diligence on the East China JV and considering the impact of the integration of East China into our own company-owned portfolio, I've come to realize that the opportunity for Starbucks in China is even greater than I had originally appreciated.

And I've been bullish from the start. We have the strongest brand and the best leadership team in the industry, significant momentum in the business that is being further accelerated by increasing digital engagement with our customers and a strong tailwind being provided by the fastest growing economy in the world. Our confidence around China is rooted in a continuation and an expansion of the strategies that have driven our operating and financial success since we first entered China almost 20 years ago. From an investment thesis perspective, there is no other Western consumer brand that comes close to approaching Starbucks' position in China. And we are truly just getting started.

With that, I'll turn the call over to the operator for Q&A. Operator?

Questions And Answers

Operator

(Operator Instructions) Your first question comes from the line of Matthew DiFrisco from Guggenheim.

Q - Matthew James DiFrisco {BIO 3948570 <GO>}

Scott, can you just walk us through a little bit, I think you said $5.5 billion for 2019. That's for the year? Or is that a run rate leaving 2019 for CAP? And if you could just break that down as far as how you report it. Or how -- what rough ballpark estimate of what we should think about coming from the company-owned stores versus the CPG and the licensed stores, those 3 other divisions that you break out?

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

Yes. So the $5.5 billion is for the full year, Matt, that we anticipate reporting. And obviously, if you think about the makeup of that, the vast majority is China and Japan company-owned stores with some licensed store revenue coming through that. And there's really not much CPG revenue that's reported in that second -- that segment. So it's fundamentally 0. That's over in CPG.

Operator

Your next question comes from the line of Jason West from CrÃ©dit Suisse.

Q - Jason Taylor West {BIO 4139501 <GO>}

Just want to clarify, Scott, you said that the comps in East China have been running below. It wasn't clear if you meant the rest of China or below the CAP segment and whether it's positive comps. And you mentioned something about closing the gap there, if you'd just talk about that.

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

Yes. So they're below the rest of China. So Belinda threw out a figure of 6% in the most recent quarter. East China's somewhat below that positive. But I would just point out we're talking 40% portfolio growth over the last few years in a relatively small geographic region. And that's been highly successful from securing real estate, taking share and growing overall revenue and profitability.

And one of the things we'll talk about as we get into next year into a full run rate basis is because of the growth rate of stores in China, you have to look at not only comps, which are super important. But overall revenue growth because so much is fueled by the new store growth rate. And given the returns that we shared on Investor Day, we continue to drive not just top line but significant profit and margin expansion as a result. Just a little difference between the 2. Belinda's getting her arms around the operation now and we talked about some of the things we can do to improve that. And I think we'll close some of the gap as we move towards next year. And I don't know. Belinda, do you want to add anything to that?

A - Belinda Wong {BIO 17337899 <GO>}

Because of the expansion in, like what Scott said, the smaller geographical area, the -- Shanghai, first of all, I just want to say that Shanghai is a very important city that we need to lead and own. And in that, I'm very pleased to say that we have a 4 to 1 competitive advantage. And to do that, we will -- in the past few years, there was intentional strategy that we accelerate the growth in that particular city. So and I'm glad we did that because we -- actually, is the #1 brand in specialty coffee market in that very important city in China.

And when you do that, you are -- you need a little bit more time to build the customer base. And when I say that, our stores and new stores that are coming from Shanghai and the East China region are still the best new store age class for this year. And I think the strategy we took in the past was fantastic. Now the comp gap, there is a gap but because it's also the timing of the acceleration of the stores as well. But the gap is not that significant. And what Scott was trying to say is that, as I'm now integrating the business, when we see how we're integrating the back-end system and also, in the future, more similar marketing activities and all that, the gap and the differences of the activities we do, it will -- the gap will be smaller. That's what we mean.

Operator

Your next question comes from the line of Jeffrey Bernstein from Barclays.

Q - Jeffrey Andrew Bernstein {BIO 7208345 <GO>}

Just 2 questions. One maybe on the operating margin progression. I know you said that you expect a modest decline in fiscal '18 but then modest operating margin expansion starting in fiscal '19. Just wondering if you can walk us through maybe -- walk us qualitatively through what you think over the next number of years, whether that modest is the run rate we should be thinking about or whether there's some stair-step function.

Trying to get a feel for the pace and where you maybe think the margin could go longer term. My other question was just, Belinda, as you operate that region, I mean, the My Starbucks Rewards numbers you gave are quite impressive. I think you said you have, you say, close to half of the number of My Starbucks Rewards numbers that the U.S. has but only 20% of the units. So I'm just wondering what initiatives have you used over there to drive that membership growth in China that maybe the U.S. could -- can learn from.

A - Belinda Wong {BIO 17337899 <GO>}

Thank you. I'll start first. And I'll turn it over to Scott. When -- I can't wait for you guys to come in May to see the market. And if you -- I mean, our MSR program, first of all, is very different from the U.S. The customers actually have to pay to be a member. So to be able to share with you that kind of number, it is a very, very good result. And that says a lot about the brand and the brand affinity of our customers. The -- our gig in China has always been introducing the Starbucks Experience to new customers.

And the other part of our job is to make sure they return and the existing customers return more frequently. We have been practicing that for 18 years and the next decade to go. So this -- like I said, the success is really about everything. It's our people. It's the relationship that we have built with our customers. And they really do treat our stores as a third place where they go at their free time.

And we really have built a very, very close relationship. And our success rate of reaching a new customer and yet they become a member, very high, that conversion rate is extremely high even in new cities. So at day 1 of new cities, you'll be surprised how many people actually sign up to become a member. So as we grow in China and the way that we have done it in spreading out and really the strategy that we have done in store development going after the key cities really provided us with a halo effect of that brand love as well.

A - John Culver {BIO 15817924 <GO>}

And Jeffrey, this is John. Just real quick. I would just add to what Belinda's saying. Also, we've been able to build strong digital partnerships with key players, Alipay being one of them and Alibaba and then WeChat and the WeChat Pay platform. We've got 60% of the tender coming through that and then 80% of the tender is cashless.

So China overall is a very digitally savvy customer. And what we're seeing is that beyond these platforms, we're able to expand through social gifting, through e-commerce. Belinda spoke about the opportunity that we see on delivery. Mobile Order and Pay will also be an opportunity for us in the future. So the digital footprint is just being built. And we see a long runway for growth of being able to better connect into our customers in a digital way.

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

And I want to add one thing to that. And I'll get to your margin question, Jeff. China is the leader within Starbucks for digital consumer engagement. And the relationships that we have with Alibaba and with Tencent and the one-to-one marketing that Belinda is able to do in partnership with them, those are the types of non-Starbucks Rewards digital relationships that we're in the process of building in the U.S. She's ahead of us. We're playing catch-up. But I think the important part there is she's get a strong Starbucks Rewards member base just like we do in the U.S. That's driving incrementality.

She's got third-party relationships that there's a partnership with. That's driving incrementality. We're building that in the U.S.. And we're going to get there. But they're some examples of what we've talked about. As far as margin, I think the most important thing is I think on the call last week, I said that CAP will, over the next several years, become the most profitable retail business for Starbucks. And it'll happen sooner than that. And what I would say, Jeff, is we'll see moderate margin expansion as we get into 2019.

I think I'd like to come back when we provide guidance and be a little bit more specific then. It's obviously early in the acquisition. But given -- it's not very often you can say an acquisition is accretive to earnings immediately. That's the case with East China. It's not very often you can say it's accretive to margin immediately. That's the case with East China as we get into '19. So I think that's very powerful.

Operator

Your next question comes from the line of Sara Senatore from Bernstein.

Q - Sara Harkavy Senatore {BIO 16508078 <GO>}

I have a quick follow-up question on that. But I guess, first, I'll ask about -- just about the equity income line in China/Asia Pac. I think we've estimated that China was maybe, I don't know, somewhere around 40% or something like that. And I guess, I was just curious, are we in like the right rough ballpark in terms of equity income? And where should that go now that it's fully consolidated? Then if I may, just a follow-up on the comment about the retail margins being the highest in the system by the end of 2019.

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

Sure. I think you're in the ballpark, Sara. The impact from South Korea would be easy to underestimate. South Korea is quite profitable. So if anything, I see people maybe over revving on the size of the East China profitability thinking that Korea is smaller. But obviously, there's a big chunk of that line that's going to go into operating income -- the pieces of operating income as we consolidate East China.

Obviously, the scale and the growth rate of both China and East China are greater than the other markets that are in that line. But Korea is a meaningful piece. And I think that's the genesis of your question. And you wanted to talk little bit more about the margin in CAP? Or did you -- can we -- maybe Sara had a follow-up question. Did she have -- okay.

Operator

Your next question comes from the line of John Glass from Morgan Stanley.

Q - John Stephenson Glass {BIO 2450459 <GO>}

Actually, that was one of my questions. So maybe you could just talk about an update. What are the unit economics in China? What is -- say, what is the average unit volume today when you combine the -- both the entity that you own before and then the joint venture? And can you talk about the retail margin if you will, either relative to other regions or an absolute? And as a follow-up, I think you do have to put some capital into some of the stores as well as some dollars into like the compensation system. Can you frame both CapEx and also just the operating expense that you need to put into the business over the next couple of quarters?

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

Yes. We'll -- I'll go through all that, John. And Sara, if you had a follow-up question, just jump back in the queue. So John, just on the profitability of China and East China, you'll remember the numbers we shared at Investor Day. Those numbers hold across Mainland China. As I said on the most recent call, they're actually a little bit better. I'll update all 3 of the significant company-owned markets around cash profits and ROI between now and earnings. I just want to have a fulsome discussion about all 3 markets.

But China is the highest and most profitable market from a return standpoint. Retail margins are quite strong. And China is getting more profitable. Those numbers are actually getting bigger if you can believe it. And so the momentum there is strong. East China has very strong store-level profitability. So the fact that the last couple of years we had a little bit lower comps should not be taken as lower profitability because the new stores are really doing quite well.

I would say, as far as investment in CapEx, most of the -- well, it's all in the guidance that we gave on the profit increment. Most of that investment is in salaries, wages and benefits that Belinda talked about. I'll just say it's relatively nominal. It's really important. It does put a little bit of headwind in year 1 because we want to make sure we bring everyone up to the right level. But it's relatively nominal. We'll lap it as we get into next year and start to accelerate.

Then as far as CapEx, there is obviously CapEx increment because that wasn't reported when East China was a JV and it will be now. We're still very close to that $2 billion guidance number that I gave despite nine months of East China store openings. There's been some puts and takes and all that. So I think I'll just make a Starbucks comment that there's no change in my CapEx guidance taking over East China. There's a little bit coming from China offset by some savings elsewhere in the business. And we still feel really good with that guidance level.

Operator

Your next question comes from the line of David Tarantino from Baird.

Q - David E. Tarantino {BIO 15144105 <GO>}

Scott, just a modeling question about the revenue outlook you gave for the segment. Can you maybe split the unit growth between company and licensed locations that you expect for 2018 and '19, maybe the total and then split between company and licensed?

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

Yes. I'll start and then I'll have Belinda. I think over the next couple of years, the unit growth that you've seen, if you look at our disclosure that we put out on the website, we split by country the growth between company owned and licensed. The licensed is East China. And the company owned is the rest of Mainland China. I would expect something similar for '18 and '19. Beyond that, I'll maybe just have Belinda jump in and add anything that you see there.

A - Belinda Wong {BIO 17337899 <GO>}

Yes. So far, I -- we are not planning to change our store development strategy in the entire China. So it â€" w will continue to -- I mean, the split has always been 55% CCO and 45% in East China. And given how important East China is and all the affluent cities, we see continued opportunities to continue to speed up the growth in that region. So that has -- that is not going to change in the next couple of years or beyond.

Operator

Your next question comes from the line of John Ivankoe from JPMorgan.

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

Just a follow-up on the margin question. Obviously, the Americas in 2016 was doing a margin -- operating margin over 25%. '17 was a down year. First quarter of '18 was down versus First Quarter of '17. So what kind of margins when you think about what CAP can become over time? Again, this isn't really a '19 or '20 question but maybe longer term. Do you think you can set margins that maybe eclipses what the Americas did in 2016? Is there anything structurally that would hold that division back that maybe we're not thinking about?

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

No. I think that is entirely doable, John, over, say, even the next 2 or three years because, as you know, China has been driving so much of the profit and revenue growth of the CAP segment. And there's margin expansion in the China business and in the JV business. And so we would expect that to continue. So not only will it probably pass the U.S. by the end of next year but even that, the high watermark that the U.S. business set, I think that's entirely doable. So we'll get a little bit more specific as we get into guidance. But John, if you want to add to that.

A - John Culver {BIO 15817924 <GO>}

Yes. I will just add that when you look broadly outside of China, the margin and the strength of the markets is very strong and whether it's a joint venture, licensed or company owned. And so we're very bullish on the growth opportunity in China, broadly across Asia and continuing to expand our margin. And Scott spoke earlier about Korea for instance. Korea is a market that we have 1,300 stores in. Last year, it delivered double-digit comps. And it's a market that is doing very, very well for us. But we've got 15 other markets similar that are doing equally as well. So very excited about the opportunity in the future.

Operator

Your next question comes from the line from Greg Francfort from Bank of America.

Q - Gregory Ryan Francfort {BIO 22252878 <GO>}

I had 2 questions, just 1 going back to the margins. I think the last number you disclosed was in china you were getting 34% cash margins before non-cash rents and D&A. So does that shake out to maybe 24%, 25% margins already kind of in China? And I think were you saying that the East China JV stores had similar margins to the existing China stores already?

Or is there a meaningful difference between them? Then, I guess, my second topic is in terms of the unit growth rate. I think you've been adding about 600 stores in China a year. Should we expect that to pick up now that you've got it consolidated?

Is the overall number going to accelerate? Or should we expect kind of 600 to 700 going forward?

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

I'll answer the first part. And I'll ask Belinda to answer the second part. The numbers that you quoted that we talked about in Investor Day, those are for company-owned stores. And that level of profit continues to increase a bit on new stores. I would say East China has very strong profitability. For Investor Day, we'll come and talk specifically about the East China pieces of that. We have not calculated that because we didn't own the market. We didn't have all of the inputs.

And so Belinda and her team are getting their arms around that. We know the profits are quite high. We know a lot about those stores. But obviously, I want to calculate those returns exactly the same way we calculate the China company-owned returns. And we want to get those exactly right. And we just need a little bit more time. So as we get to May, we'll talk a bit about that. And Belinda, if you want to talk about new store opportunity.

A - Belinda Wong {BIO 17337899 <GO>}

Well I guess, you -- on our track record, right, we have been trying to be -- growing in a very disciplined way. And every year, we accelerate a little bit to try and make sure our people are ready and that we learn from our new stores that we opened earlier. And so far and as we speak now we are now at a pace of 500-plus stores every year. And I just talked about the Quarter One where we have achieved a new record. So you can see that we're practicing again how to really accelerate growth.

Now I talked a lot about the opportunities that we see. We definitely see, now that we own East China and the rest of the China that I've been running for the past seven years, there are opportunities. Now -- but what it is important is that we need to make sure we continue to find the right real estate. We got to make sure we have the right people to run those stores and to build that experience and relationship. And while we grow -- and I don't think I'm going to chase like the number of new stores.

I want to make sure my new stores are open in a quality way in both numbers and also experience. So opportunities are there. There are a lot of development in China that we're looking at in terms of real estate and stuff like that. So but we got to be -- we got to pick the right ones and making sure that every store is a profitable one. And it gives us the return that we all like. So the short answer, we want to accelerate. But we got to accelerate it in a disciplined way.

Operator

Your next question comes from the line of Karen Holthouse from Goldman Sachs.

Q - Karen Holthouse {BIO 17433865 <GO>}

A pretty quick modeling question just to make sure we're netting out sort of what we're adding back versus what we're taking out. Can you give us a sense of why the tax rate you were using on the joint venture income was and then confirm the tax rate guidance we got last week does reflect the sort of P&L tax rate post the acquisition of China?

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

Yes. I think the best way to talk about the tax rate for me, Karen, just so I can keep it straight for you guys is to talk about both the reported GAAP effective tax rate but probably more importantly, given the acquisition. And you'll remember that the acquisition had the 5 point impact on our reported GAAP tax rate this year because the gain is largely tax free.

So that won't impact going forward. And so the key rate for Starbucks on our overall financials is that 27% non-GAAP effective rate. And I wouldn't expect, based upon the modeling we've done, a big impact in that tax rate based upon the run rate of China. So said differently, if I think I understand your question, where that moves within the P&L, whether it's JV pickup or full consolidation, that's not going to have a material impact on that overall tax rate for your modeling.

Operator

Your next question comes from the line of Andy Barish from Jefferies.

Q - Andrew Marc Barish {BIO 1512077 <GO>}

Yes. I guess, on the segment data right now when you look at the margins, which we've seen with other China businesses. And I know CAP is obviously more than just China. But the cost of sales and occupancy is running significantly higher than the Americas. And store operating expense is lower. Is that a product mix issue at this point or supply chain? And if so, on the product mix side, can you give us a little sense of what that -- what the current China product mix is around your beverages, food, et cetera?

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

Yes. There's not a big difference between Americas -- or the U.S. and the China cost of goods sold. Japan runs a little bit higher cost of goods sold than both of those markets. And obviously, today, Japan is weighted in much heavier than it will be a year from now. So you're getting a little bit of what I would call country mix in that. Andy. And you know that the profitability in Japan is quite high. But the COGS rate is definitely higher in Japan. And maybe, Belinda, do you want to just spend a few minutes talking about sales mix in China just to let these guys know what's driving comps?

A - Belinda Wong {BIO 17337899 <GO>}

So I guess, I'll focus on the differences in -- with the U.S. I -- first of all, the obvious difference will be the food mix. Currently, we're running at an average of 11% food mix. And it's half of what U.S. is doing. And that would obviously impact the COGS, right, just by a mix shift perspective. So that's -- we -- by the way, we see food as a very important opportunity that we have as well as we integrate East China. And then we'll be able to streamline suppliers and then -- and increase the attachment there.

So and the other mix, it's pretty normal in terms of our beverage is the most important one. And one thing that is worth saying is that tea is picking up a lot and food is also growing and -- but at 11% right now. And I think the mix is just it hasn't -- well, I'm very happy to see because of the fact that we're comping every quarter very helpfully with transactions, every category is also comping as well. So I'm very happy to see what I have now so.

Operator

And your next question comes from the line of Will Slabaugh from Stephens Inc.

Q - William Everett Slabaugh

I had a question on China comps and CAP margins. Just given how fast you're growing comps and margins, I'm assuming there's some level of cannibalization taking place and some level of inefficiency in cost of sales and labor. So along the same lines of trying to understand what this business could be over time, is there any way to quantify either one of those?

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

What I would say is if you look at East China, we've definitely seen, given a 40% portfolio grade over the last three years, a lower level of comps. And that's because of exactly what you're talking about, that sales transfer. It's sort of 10x the portfolio growth rate in the U.S. Now the market is growing so quickly. Belinda and her team have done an amazing job to grow stores at 40% and have positive comps. But there is a little bit of sales transfer there in some of those cities.

And so that is something that we'll continue to watch while we make sure that we're growing with the opportunity that exists from a market share standpoint. I'll start but I'd like Belinda to comment. When we look at cost of goods sold and labor as a percentage of retail sales. So at a store level in China, it actually stacks up very well with the U.S. market. So they're, particularly in company-owned markets, highly efficient, at least from my perspective, in driving those lines.

A - Belinda Wong {BIO 17337899 <GO>}

I think one thing that I would add is that because we're a high-growth market, right, when you're opening 500-plus stores every year, you have to train a lot of people. And at a store count, six years ago -- or five years ago, I mentioned 700 stores. And every year, your percentage of new store is so high that when you're pacing your growth over the year, you got to get the people ready. And they're in the store training as well. Now our base is higher every year now and so the labor, it's -- you have to take into account where we have existing stores that's running, that existing store plus the labor we need to get ready for -- to fuel the growth every month that we have to open.

A - John Culver {BIO 15817924 <GO>}

And Will, I would just add to that, right. So we built -- Belinda and her team have built this engine around new store development and design. And that engine is working very well for us. It includes not only being able to get the stores open but having the people in place in the right way to operate those stores. We see that engine continuing to be leveraged now across East China as well as the company-owned markets. So that's number one. Number two, I would just add that when you look at our growth in China on the same store sales on comparable sales, over the last several years, it has been driven majority by transaction growth, right.

So what that tells us is that although we are opening stores at a record pace, we are attracting more and more new customers into Starbucks every day. And we're increasing the level of frequency of our existing customers. So for us, that's all the more reason that we are very optimistic about the growth opportunity that a consolidated China brings us, whether it's in East China or whether it's in the rest of China where we operate our stores. So we don't see slowing that down. We see continuing to enhance it. And as we've said on our past calls, this is going to go on for decades for the company. And one day, we do believe that China will be the largest market that Starbucks operates anywhere in the world.

Operator

And your next question comes from the line of RJ Hottovy from Morningstar Research.

Q - Ronald John Hottovy

I have 2 questions, 1 regarding CapEx and expenditures beyond 2018 and again with respect to rewards. Scott, you talked about the incremental CapEx for 2018 and fitting within that $2 billion guidance. But wanted to get a sense or get your thoughts what kind of incremental CapEx we might be looking at beyond 2018 as you look to things like CPG build-out, new retail formats or -- and even infrastructure improvements. Then on the rewards, given that you already have a strong digital relationship and that there is widespread acceptance of things like Alipay and WePay, what types of My Starbucks Rewards partnerships or Stars as Currency partnerships might you be looking at down the road? Just anything you have there would be helpful.

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

Great. I'll take the CapEx question. Then, I'll give the digital question to Belinda. What we talked about is the increase this year to the $2 billion really ran across our new stores globally and renovations to those stores, some things we were doing in the corporate support centers and supply chain, including some additional manufacturing plants. I'm talking globally now, not China. Then the third thing was Reserve Roastery and Princi. And so I believe what I said in the last call.

And I think it still holds with East China coming in, is 2 out of those 3 things are likely to continue, obviously, new stores and Reserve Roastery and Princi. I think some of that corporate CapEx is onetime and will likely come down. And so as I think about 2019, I mean, it's really early. But that's kind of how I think about rolling forward the CapEx. And we've been able to -- with East China and the number of stores we'll build using our own capital, we've been able to sort of put that into that capital budget as it fits. So you want to talk digital, Belinda?

A - Belinda Wong {BIO 17337899 <GO>}

Yes. So in terms of My Starbucks Rewards program, we're just barely getting started. And what I mean by that is that there -- right now the majority of the -- we just opened up another on-ramp, a new way to become members. With all the digital relationships on other platforms that we get, we are now able to connect with our customers. We want to turn the higher conversion rate for them to become members. And as we grow stores, there will be new customers wanting to be members, right? We can do so much more on the personalization of marketing. And we just started building out Stars. And then we wanted to leverage the learning in the U.S. to have Stars as Currency and to create more programs and value behind that for our members. So there are lots of things we could do.

Now I want to talk a little bit more about other digital experiences that we could do -- we can expand as well. For example, I can't wait to launch delivery in China. And that was going to create a whole new other business revenue stream for us and also MOP because I have such a great even daypart. In all 4 dayparts that I have, I don't have an urgency to do MOP to have -- to take care of any throughput issue. However, because of the digital savviness of our customers, I can't wait to offer the mobile order experience for our customers as well to have a more robust Starbucks Experience in and out of our stores.

Operator

Your last question comes from the line of Brett Levy from Deutsche Bank.

Q - Brett Saul Levy {BIO 18965727 <GO>}

This is more of a strategic kind of question. If you could share a little bit about what kind of learnings or possible missteps, if there were any, with the Japanese acquisition, if there's anything you think that you did with the Japanese transaction that might make the transition and the integration of the East China and your traditional China business into something that's potentially more seamless or profitable or speed up the process, anything you can share?

A - John Culver {BIO 15817924 <GO>}

Yes. Brett, this is John. I think what we've learned from Japan, we're even more focused and sharpened our intentions in the work going into the East China integration. Let me give you a couple of examples. First from an IT infrastructure perspective. We learned in Japan that there was a bigger opportunity there for us than we actually realized. And we've gone into China eyes wide open and really gone after and looked at the infrastructure that exists in East China today and the ways in which we can invest now that's going to help catapult our IT capabilities much faster. That's one area.

The second area has to do with supply chain and making sure that our supply chain is set up in the right way. And it's not so much we didn't do it right in the Japan acquisition because that was already operating as one total market. It was just joint venture structure. But in China, we've got a great opportunity to leverage what we know from our company-owned business on our frozen food platform. And we have a great opportunity to learn from our East China joint venture on a fresh food platform and take the best of both worlds and bring that forward.

Then the last piece is around talent and the opportunity to make sure that we're leveraging the talent now across the entire mainland to put people in the right places, to drive the work that needs to be done and to make sure that we are growing our talent and giving them opportunity to become the future leaders of the business. So we're much more savvy about that, I would say, given the acquisition that we went through in Japan and now moving into East China. And that's really what excites us. So very excited about that opportunity.

A - Belinda Wong {BIO 17337899 <GO>}

If I may add, don't forget we have been operating as a company-operated market in China for many years. We've got the relationship. We have the experience in -- not in East China but the rest of the China -- but the rest of China. So we have spent significant amount of time building the infrastructure for our growth in the company-operated markets with in mind how would that turn out if we owned the entire country, right?

So and the second point that I want to make is that we have been working with East China team for the past decade. Together, we grow China market and accelerate the growth there. So it would make it much easier for us now that we went -- we're going in and started the integration to understand and just go right into what we need to integrate, what we need to up level to enable us to come up with the right infrastructure to scale to 5,000 stores and beyond by 2021.

Operator

That was our last question at this time. I'll now turn the call over to Scott Maw for his closing remarks.

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

I want to thank everyone for joining us today. I want to thank John and Belinda for their time. We'll have a chance to talk about China again in April. And I encourage you all to come to China in May. I just want to reiterate that, personally, the more time I spend on China and preparing for the call doing the acquisition, the more excited I get about the opportunity. And I highly encourage you to come and see what Belinda and her team are doing in the market. Thank you.

Operator

This concludes Starbucks Coffee Company's China Modeling Conference Call. You may now disconnect.