Bank of America Merrill Lynch Consumer & Retail Conference

Company Participants

- Scott Maw, CFO
- Troy Alstead, COO

Other Participants

- Joe Buckley, Analyst, Bank of America Merrill Lynch
- Unidentified Participant, Analyst, Unknown

Presentation

Joe Buckley {BIO 1491816 <GO>}

I'm Joe Buckley, Bank of America Merrill Lynch's restaurant analyst. We're very pleased to have a (inaudible) day here at our conference.

And very pleased to welcome Starbucks, even more exciting than usual, because we are introducing Troy Alstead in his new role as Chief Operating Officer and Scott Maw in his new role as Chief Financial Officer. And with that, I'm happy to turn it over to Troy Alstead.

Troy Alstead {BIO 5724238 <GO>}

Thanks, Joe. Good afternoon, everybody. I will just make some introductory comments. And then I'll turn the conversation over to Scott Maw, our new Chief Financial Officer.

Let me start by saying Starbucks has a long, demonstrated track record of consistent growth in the business, strong growth in revenues powered by very consistent, sustainable growth in same-store sales globally, operating margin expansion, growth in earnings per share at a much more rapid clip than the growth in the top line. And as we (deployed) capital into the business increasingly over time, we've also concurrently elevated return on that invested capital in the business.

And I should point out that this progression of strong earnings growth and margin expansion has come often during times of extreme coffee cost, often much more volatile and extreme than what we're facing today, which is why we're not overly concerned about what's happening with coffee cost today as it impacts our business. And equally, we are extremely confident in the continued trajectory of our earnings growth going forward, despite what's happening in the coffee market today. And Scott will talk a little bit more about that here shortly.

Today, Starbucks has been a leadership position globally, the premium operator of coffee shops around the world and the premium coffee -- super premium coffee brand anywhere in the world. With that leadership position, we sit today on the front edge of a new set of growth opportunities globally, diverse global opportunities to drive profitable, huge trajectory of growth throughout out business around the world.

And that starts first with growth within the existing 4 walls of the Starbucks store, starting first with huge opportunities to continue adding food into our stores in a very elevated way to drive new layers of growth and profitable growth within the stores, continued beverage innovation, innovation within the existing core of our beverage opportunity. But also innovation going after new consumer needs space such as refreshment in the afternoon and other day parts, such as tea in a much bigger way within the course of the Starbucks store.

We have opportunities to stretch day parts like we haven't ever historically. We have opportunities to elevate throughput to drive that line much more quickly in the morning within the store and also in the drive-thru opportunity.

So continued opportunity, continue adding layers of growth within the Starbucks store and to drive those economics. And we believe average unit volumes, which, in the most recent year, have peaked at 1.3 million per store in the U.S., to much higher levels over time.

We, in addition to the strength of those unit economics, we have opportunity to continue elevating the -- and accelerating the pace of our new store development around the world. With the 4-wall profitability we have in the very strong classes of new stores we've opened recently, combined with increased innovation around the design and concept development of our new stores, that's opened up opportunities for depth of store penetration like we never have experienced in our past.

We now have open to us container stores, which are very brand accretive and expand and give us opportunities. We have open to us walk-up-only stores, drive-thru-only stores. We have ski-up stores. We have stores in trains. We have access to traffic and store designs and profitable store formats that have opened our eyes to sets of opportunities to go after customer (need space), to meet convenience for customers. And, again, to access traffic and to gain share in our business like we've never done historically.

That has given us opportunity both in the U.S., our largest market of anywhere around the world, to accelerate store development in the year ahead, which we will do. And increasingly outside of the U.S., as we've become quite proficient in our store development, real estate. And store design capabilities all around the world.

Further then, as we build the brand awareness, the customer experiences, the products within the 4 walls of the Starbucks store, we have significant opportunity then to extend those opportunities outside of the Starbucks store through our channel development business, which is a high-margin business, double-digit revenue growth opportunity in the U.S.. And increasingly in China and Asia Pacific.

All of that opportunity within the stores and outside of the stores, is significantly leveraged by our unmatched leadership position in digital and loyalty and in mobile payments. Starbucks very quickly became the largest mobile payment retailer in the U.S.. And we think around the world. We are just at the early days of leveraging and extending that much more meaningful to accrue those benefits within the Starbucks store. And we think we can extend that further as time progresses. And of course, all of that has been built on amazing partner and customer experiences within our stores.

With that introduction, I will turn the presentation over to Scott Maw. Scott's our new Chief Financial Officer, replacing me, as I've moved into my new role in the Company. Scott has been with Starbucks for a few years now. He brings a long, strong background in finance prior to Starbucks. He's been a senior finance player within our organization for the last few years. He's been a public company CFO prior to this. And has brought a great deal of talent and capability to Starbucks. So Scott.

Scott Maw {BIO 18637895 <GO>}

Thanks, Troy. Good afternoon, everyone. As Troy talked about, we have a number of significant growth opportunities in front of us. And I'm going to spend a few minutes today just highlighting a small handful of the largest ones.

The first thing I'll point out on the slide is, you can see Americas is about 74% of our revenue mix today. If you go back three years, that was about 80%. So as we've grown international, particularly in China, Asia Pacific. And we've grown the channel development business, we see diversification within our revenue streams.

But focusing specifically on what Troy touched on. And that's the store development and store new-build unit opportunity. We're targeting 1,500 stores in FY14. You can see the split there on the board. About 150 will come out of EMEA. Virtually all of those will be licensed stores. We'll have 750, about half, in China, Asia Pacific. We'll talk about China in a minute. Then about 600 in Americas.

And if you look out within Americas, we're -- Troy talked about this. But we're particularly excited about several places in Americas, including the U.S. When we look at our most recent age class of stores, actually the last couple years, we see AUVs in those stores at levels that are among the highest we've ever seen in our history of the Company. We see growing levels of profitability. Those stores are getting up to speed very quickly and contributing significantly to our growth.

So that gives us the confidence when we look in the U.S., to continue that store growth at the level we've had over the last couple of years, with some more traditional format stores, including drive-thrus where we see about a 25% sale lift over non-drive-thru stores. Some of the newer, more non-traditional formats that Troy talked about, things like where we've put 2 railroad containers together and created a drive-thru-only store, putting that out in an industrial area where there's fantastic car traffic. But limited foot traffic. So there's nowhere to go in and sit down. You can walk up to the store and you can drive up to the store. We're seeing fantastic AUVs and tremendous return on those types of stores.

So I would say in the U.S., we've never been more confident in our ability to build profitable stores. We may lean in selectively both in the U.S. and in other places in the world to accelerate store growth where we see opportunities.

Then specifically talking about China. So we've continued over the last few years to increase our store growth in China. And, again, we're seeing the same thing in the most recent stores that we saw in the U.S., great revenues, fantastic returns. You can see the ROI for the China, Asia Pacific on the board there at 63%. We're seeing similar kinds of ROIs in China. So we have a lot of confidence that we can continue that growth in China, perhaps selectively look at ways to go a bit faster.

But behind all of that in China and in the U.S., is a lot of discipline around store growth. So coming through 2006, 2007. And 2008, we learned a lot about the types of stores that we should open and those stores that don't do quite as well. And we're apply all those learnings and we're watching stores in China and the U.S. by age class, by geography, by type of store, store by -- almost every way you can cut it to make sure they're performing the way that we want. And if we don't see the performance we want, which is pretty rare. But when we don't we make adjustments to address that. So lots of opportunities in store growth.

When I look at the other big opportunity for us is around beverage innovation. So we've talked about beverage innovation over the last several years has typically given us 1 point to 2 points of comp growth each quarter. Sometimes it's a little higher in the range, sometimes it's a little lower in the range. But pretty consistently delivering significant comp growth for us. And a number of things have driven that.

If you look at refreshers as an example, we generated about a point of comp growth with refreshers last year, meets an afternoon day part where traffic is a little bit lower in the stores, meets a different need state than say a Frappuccino or an ice coffee drink, something a little more refreshing. And so it's kind of a win on 2 scales, (because it's) a different customer segment and a different day part.

We've continued to innovate within our espresso platform, which include things like macchiato. We have a vanilla macchiato in the store right now as a limited time offering. And that's doing quite well. We're seeing things around our holiday and seasonal offering. So pumpkin spike latte, believe it or not, 10 years in this pumpkin spike latte, it continues to comp itself quite nicely. And so that kind of innovation and those seasonal offerings, whether they're new or existing, have driven nice comp growth for us.

Things around brewed coffee, you can see Clover there in the lower left-hand corner. Clover's been a great innovation for us. And we continue to roll that out in stores. Then our Reserve Coffee, which continues to sort of elevate that coffee authority for Starbucks in the brewed space.

Then coming this summer across the sunbelt states, which is about a third of our stores, our handcrafted sodas. So we tested 3 flavors of handcrafted carbonated sodas in Atlanta and Austin and actually in Japan as well. Fantastic response from our partners. Fantastic response from our customers. And we're rolling that broadly across the sunbelt this summer. And then looking to roll it more fully across the U.S. next year.

So we continue to be quite confident in that 1 point to 2 points of comp growth coming from beverage innovation.

Moving on to food, I think food is probably the biggest near-in opportunity that we see. And if you can just look at the scale of transactions coming to the store that don't attach food. So 30 million out of 40 million transaction a week don't have food attached. Food has grown nicely over the last 10 years or so, to about 20% of our revenue. But we still think there's big opportunity to increase that percentage.

And obviously, that's where La Boulange comes in. In its early days of La Boulange. And I think you guys know this math. But just to make sure. We're about 50% rolled out with the bakery program within La Boulange. And the bakery program is about half of the food in Starbucks. So we've impacted about 25% of the overall food platform in La Boulange. And that's why we continue to say it's early days.

But what we see in the results of La Boulange, the customer reaction, the pride that our partners have in an elevated food experience has well met all the expectations, rather lofty expectations we had at launch. And we're doing some things to adjust and improve the food program. We've had some things that have gone far better than we thought where we see things like croissants that have doubled sales from pre-La Boulange levels.

And we're adjusting some things in the operations as well to get at some of the expected little hiccups we've had in the rollout. Again, this is an enormously complex rollout. We knew we'd have some little wrinkles. And we're ironing those out as we move forward.

So overall, we're very happy with the sales result in La Boulange. We're very happy with the lift. And La Boulange, if you look at food, food also has contributed 1 point to 2 points of comp growth every quarter over the last three years. And most of those quarters, actually the vast majority, it was 2 points of growth.

And so when we look over the next couple of years, we know La Boulange will give us some comfort level in continuing to at least meet that same level of contribution from food comps -- or from food in comp growth. And what I would say is, the rollout of La Boulange smooths that food impact slightly.

So it's going to be a multi-year rollout. We're already lapping stores that we rolled out the bakery product in a year ago. And so we'll see 1 point to 2 points of food comp growth, a great contribution from La Boulange this year and heading into next year as we start to launch the lunch platform, once we get bakery (landed).

So good early days on La Boulange.

To touch on tea. So tea is another opportunity we're very excited about. It's $100 billion category in tea. It's a growing level of consumer acceptance, growing level of frequency among U.S. tea drinkers. And it's 9% of the sales in our stores. And I think a couple things about that 9%. Number one, I think it's significant enough to show that customers, a lot of customers do come into Starbucks and drink tea today.

But I'd also say that there's a huge opportunity, we think, to grow that percentage up significantly from 9%. And the key for us, obviously, in the tea space is our Teavana acquisition. And Teavana brings us a couple of big things, probably in the more near-term, an ability to rollout Teavana products in Starbucks stores. So sometime this year, you'll see the introduction of some Teavana products behind the bars, in prepared drinks, in handcrafted drinks in Starbucks stores.

You'll also see over time probably some additional things like merchandise and perhaps some loose-leaf tea in Starbucks stores. But that's later as we head on in to next year.

Then the second opportunity is really around the tea bar concept. So we have two tea bars that we've launched, one in New York and one in Seattle. And they're really fabulous places. If you haven't been in one, you should go. When you walk into the tea bar, you can order a handcrafted tea beverage. It can be hot or iced. So there's tea bar. There's a food offering that's different than the food offering in Starbucks.

There's the tea wall, that if you've ever been in a Teavana retail store in the mall, there's dozens of loose-leaf teas that you can order from the tea wall. That exists in these tea bars.

Then there's a subset, a selection of tea merchandise, high-quality tea merchandise that we sell in the mall stores and Teavana.

And all of that is going quite well for us. And we're learning a lot. We're adjusting how we staff the stores, seating, food mix. We're just constantly learning what works and what will be optimized with the Teavana stores.

We'll launch a couple more Teavana stores this spring. We'll learn from those and we'll continue to grow in the U.S., as time goes on. We also think the Teavana tea bar concept has legs internationally. So we'll look to launch that over the coming years as well.

So that's tea. Then tying it all together is card and MSR and our digital assets. So in the last year, we had almost $4 billion of cards load -- or dollars loaded on Starbucks cards. That's up 38% -- sorry -- 28% over the prior year. And we have more than 7 million My Starbucks Rewards members. And about half of those are gold members.

From a transaction standpoint, about 12% of our transactions are done on the phone and about 30% of overall transactions are done on some form of the card. So customers are using it a lot. And on that 12%, that's double from a year ago. So we're seeing increased traction around customers using this as a payment device.

And I don't know if any of you use this. But this is pretty much on autopilot for me. I've got it on auto reload. It's got my stars loaded on it. I walk up, I scan it. And that's pretty much done. I don't really even keep track of what's being loaded on it. But lots of customers are seeing the benefit from that.

What we get out of all those digital assets are a few big things. First of all, it speeds service through the lines. The fastest way to pay is using your mobile app. So partners love it, given the speed of service. Customers obviously love it, given the adoption rate that we talked about up there and the convenience.

Then it gives us quite a bit of information and ways that we can market to our customers. So we're building and using a marketing database where we can have one-to-one targeted marketing to our customers done in the right way. And some of that marketing is offers for discounted food or buy-one-get-one kind of offers.

And some of that is just sort of awareness marketing where we talk about La Boulange sandwiches that have -- breakfast sandwiches that have rolled out or a new Starbucks is opening in a neighborhood near you. And our ability to use digital marketing as a higher percentage of our overall marketing is a win for us because it's easier to measure, we see what the benefit is, we can make adjustments to the program and get smarter with our marketing. And so that's something that we're looking to grow as we move into the future.

Let's talk about coffee. Troy covered this a bit. But there's been some dry weather in Brazil has really been what's kicked off this most recent coffee price spike. If you look from November to now, it's almost double, the price of coffee. So there's some concern in Brazil that dry weather might impact production. We won't actually know. When we look at the coffee trees, there are just as many cherries on the coffee trees this year as there would be in any year. The question is, because of the dry weather, what the production will be, what will be a yield impact? We'll know that in a few months. But the market's obviously reacted.

So just to talk a little bit about where we are. We have virtually all of 2014 price locked. 2015, an update through last week, we're about 40% price locked for 2015.

And that's at prices slightly below our 2014 average cost.

And as we look forward, just to put it all in perspective. And Troy talked about this. So coffee is about 15% to 20% of that COGS and occupancy line on our P&L. And it's about 10% of total store cost. So while it's important, when you put that in perspective. And remember COGS and occupancy is just one of the cost drivers on our P&L, I think it's easy for people to sort of overstate how much coffee actually impacts our P&L.

And what I'd also say is, to Troy's point, we have a long history of overcoming cost headwinds. In fact, if you look at 2012, which is the year we had the most significant impact from coffee costs, we delivered at the upper end of our 15% to 20% EPS guidance.

And so as we look forward to 2015, we're watching this, we're taking it seriously. We're doing everything we can to manage it. I should mention that the price coverage that we have today is over two times as much price coverage that we had in 2010 and 2011, when we headed into the last coffee price increase. So we're in much better position. And the P&L can handle some coffee cost headwinds if they do, indeed, materialize.

Just quickly on margins. So we've been expanding margins globally every year. We expect that to be the same thing this year. We focus on a lot of the things that we've already talked about. So clearly, we have strong sales leverage. We see increased opportunities and cost of goods sold to drive further efficiencies above what we've already driven over the last few years. So that's something we'll be looking for in the next couple years.

When we look at the new leadership structure, part of the reason that we feel confident over the next 12 months or so that we can drive additional cost of goods sold savings, is the new leadership structures puts around sort of Troy's leadership table, all the business leaders, supply chain, IT. And finance. And we should just be much quicker at getting at the opportunities that exist within the supply chain. So that's helping to drive margin expansion and that should accelerate in the future.

On ROIC, Troy talked about this. We've talked a lot about the numerator of ROIC benefiting from the earnings growth and from margin expansion. On the denominator, we've been increasingly focused on working capital. If you were to go back a couple years and pull out our green coffee inventory and look at how much working capital we had tied up in green coffee inventory, it's almost double where we are today.

We've done a number of things working with our partners and supply chain to create work streams to reduce working capital, have more just-in-time inventory, get the coffee where we need it when we need it. And that's allowed us to significantly cut the amount of coffee that we have physically on hand, while at the same time we actually increase our price coverage through improved derivative and contracting capability.

So that drops to the bottom line from warehouse savings. It drops to the bottom line for reduced waste, less cost of moving product around. And, obviously, has a lift on our working capital.

And last, on shareholder returns. So dividends, we increased the range from -- or two 35% to 45%. And we're committed to offsetting dilution from our broad-base share plans on stock buybacks. We will look to selectively buy back stock beyond that anti-dilution impact if the opportunity is there in the market.

We also post our recent debt offerings have still significant debt capacity, not that we're looking to ramp up debt. But we'll probably selectively add a bit to our leverage over time and we've got plenty of room to do that and still maintain our A-minus rating target.

So with that, I'll stop and turn it over to Q&A.

Questions And Answers

Q - Joe Buckley {BIO 1491816 <GO>}

Okay. Thank you. (Conference Instructions) I'd like to kick it off with a question to Troy. We have all gotten to know you very well as CFO. And you certainly had a vision for the business as CFO. Now (you're) going to expand your roll, can you talk about how you view yourself in that new roll and visions and goals over the next several years?

A - Troy Alstead {BIO 5724238 <GO>}

I will. Let me speak to what I think is a huge, huge opportunity. And I'd even say necessity in the business as we go. And we've recognized this -- and, by the way, many of you, I think know this. At Starbucks, we are always managing and driving through the business significant numbers of opportunities.

First and foremost, I would say, today we have our arms around the execution of those various growth initiatives and expansion opportunities more than we ever have before in our history. We also look at the last five years. And I've had a chance to be part of our business for more than 20 years now all over the world. And if we look at the last five years in particular, we've seen a fantastic track record of growth in the top line, margin expansion, growth around the world, channel development, earnings through share growth, return on capital expansion as Scott just articulated.

We look at that and we say, well, how do we replicate that in the next five years? What does it take to develop that same kind of and then execute against that same kind of progression and all the financial and business metrics ahead of us in what is an increasingly large business around the world and increasingly diverse business and increasing opportunities that we face?

This org change and specifically coming to my role, really is all about focus. It is focus, on the one hand, into the operations and the execution day to day in the business by collecting, for the first time ever in our company, all the business leaders and supply chain and finance and technology in one place, the functions that most immediately every single day impact the business or have the ability to impact the business, where we need to be much more nimble, we need to execute, we need to make sure we're delivering on customer experiences and driving opportunities throughout the business every day and globally. Those are the things we can focus on more than ever before.

We have significant opportunities to take best practices out of our high-performing U.S. business where we've made, as you know, the most progression in the last several years around margins, around customer experience, around AUVs. And harvest those more systematically and drive those throughout the businesses globally. Things that are hard to do in big systems, for as much as we always want to do that, we now have more incentive, more capability. And I'd say an organization that will support doing that much more frequently.

Scott mentioned supply chain, a few opportunity, the single biggest category of spend we have anywhere in our company is collectively our supply chain organization and the money that that organization touches. It also has significant impact every day on execution, on daily whether products make it to the store or not, on our ability to launch carbonation, our ability to support food as we're developing it.

Great opportunities both to become more effective over time as we drive supply chains throughout the business. And to continue to become more efficient and extract cost out of that huge, huge pool of cost, by being plugged into the business just much more robustly and holistically than we ever have before. That's how I believe, with this organization, we can drive some focus.

I would say, on the other hand, it also allows us with where Howard is increasingly able to focus on innovation and growth, on our digital opportunities, on creative opportunities, on how do we -- what's the next layer of revenue growth within the Starbucks stores. All those things also in this new structure have a chance to have much, much more focus than ever before.

So that's what this is all about, is in multiple ways about focus on the business. And that's what gives me confidence that over the next five years we can continue to deliver against our target.

Q - Joe Buckley {BIO 1491816 <GO>}

Having asked the long-term question, I'm going to ask the short-term question, (so) I'm not driven from the ranks of analyst. Could you provide some perspective on the

December sales performance for the quarter and, I guess more specifically for the month? And how are you thinking about it going forward?

A - Troy Alstead {BIO 5724238 <GO>}

Yes. So in the month of December, what we saw is a little bit of slowdown from the trends that we had coming into our Fourth Quarter and in the first part of our First Quarter. And to put that in a little perspective, we talked a lot about the traffic impact from what we see as an acceleration of what's been a trend for a few years of people aren't going out shopping as much in December.

And we don't have a lot of mall-based stores. But when people aren't out and about, they're not visiting our other stores as frequently as they were, say a year ago. And we saw some impact from that. Now, we still had nice comp growth in December. We still had good comp growth for the quarter. So we think we weathered it better than, perhaps, average. But we definitely felt that.

We also had some other impacts in there. We definitely had a bit of weather in December. We had an impact where it's a little bit of a vagary for us, where a Wednesday for Christmas, it's not the best day for us. When it's in the middle of the week like that, people take more time off. They disrupt that routine that they go through. So we saw that impact a bit.

But overall what I would say is, just a little bit of slowdown in December. We saw that traffic impact that Howard talked a lot about. And we think we're quite well positioned for that over a longer period of time, just given the nature of our product, the connection we have with our customers, how much people enjoy coming into the (third) place and spending time and having that connection with baristas. And then some of the things we're doing on the digital front.

Q - Joe Buckley {BIO 1491816 <GO>}

Could you comment about product innovation, the pipeline for that? It's been such an important part of the Starbucks story for a long, long time. And where you stand currently.

A - Troy Alstead {BIO 5724238 <GO>}

Yes, I'll comment. And Scott, feel free to join in. Our innovation pipeline, I will tell you is deeper and more robust, we think more shaped by consumer insight, more relevant today than it's ever been. We've always prided ourselves on being a very innovative company. I think that was very, very true.

As we've come to the last handful of years, what we have done in the space of our innovation capability is to deepen our focus around consumer insight, (while) still looking around corners and understanding where the customer is going. But being heavily driven by what's relevant today. How do we drive that second visit of the day? How do we understand how our customers want to use a Starbucks store that's relevant to what we're all about and relevant to our history and our heritage. And then build upon that?

So we have product innovation in beverage that is, on the one hand, right within the core of the traditional espresso and coffee offering, the macchiato platform that we launched a year ago. And we continue to innovate against, all the way to the other side of things, which is very still consistent with the coffee house and the Starbucks store experience. But going after the refreshment needs space. With refreshers a couple years ago, with carbonation coming into the stores in an elevated, handcrafted, very customized way as we launch that in the sunbelt stores this summer.

So we've got a long runway ahead of what we believe will be very hard-hitting, relevant innovation that's profitable that's driven by customer need space.

Similarly with food, food is a huge opportunity for us, as Scott articulated. And what's important to know about food is, the ultimate success of food will be, of course, selling more food and attaching more food to that existing transaction. But very importantly, food is a huge driver of a person's decision to come at different day parts. First of all, for example, at midday, where we didn't used to have a midday day part within Starbucks whatsoever, we built that the last two years. And that continues to be the faster growing part of our day, even compared to our very healthy, rapidly growing morning day part.

And we also know over time that as we elevate food it really rise -- all ships rise. Beverage sales go up when we have food that's better for people, that people want in our stores. They come in, they'll buy the sandwich and they'll pair some beverage with it.

So significant innovation coming around product offerings from the stores that's, again, giving us a great deal of confidence in our ability to continue to drive those incremental points of comp growth from food and beverage innovation in the stores.

Q - Joe Buckley {BIO 1491816 <GO>}

There's a question here. While we're waiting, could you elaborate a little bit on La Boulange? And follow up with a food question. You've talked about it being the most significant change to the stores from an operating standpoint. Would you just elaborate a little bit on that?

A - Troy Alstead {BIO 5724238 <GO>}

Sure. Scott?

A - Scott Maw {BIO 18637895 <GO>}

Yes. So I think with La Boulange, there's the operational impact in the stores, the warming routine. And given the up-leveling of the recipe, the impact on many of those food products when you warm them is significant. So that's something that we're committed to. And we tested that and we added labor correctly. But obviously, choreographing all that took some study and time to get that right.

Also, the supply chain was significantly impacted in bakery. So we went to an all-frozen supply chain where we're making these great products, flash freezing them. And then shipping to the stores. And buying them. So getting that routine right with the supply chain, buying routine right in the stores was something that we investigated, invested in. And we think we've got right now.

Then just the customer reaction, right? It's an up-leveled food experience. Our customers are more proud about it. They want to educate customers about it. Customers see the warming. So just getting them through that level of change. It's all of that added together that makes it complex. Then it's big, right? It's touching half of our food platform.

So I think adding all that together is the complexity we talked about.

A - Troy Alstead {BIO 5724238 <GO>}

Now, if I can just add to that briefly. And then we'll go to the question. All of that work and effort, all the checking and adjusting, the acquisition, the investment in these capabilities and capacities, it's important to keep all that in context.

We have 70 million transactions a week in our store system, two-thirds of which don't have food on them today, or historically. The opportunity is to create that -- to make that two-thirds a lot smaller as time goes on. 10 years ago, food was 10% or 12% of the sales mix of the typical Starbucks store. It's now 20%. We see no reason why we cannot continue to expand the component of food within the stores, consistent with what Starbucks is all about, meeting those customer, even exceeding our customer expectations and having that be a highly incremental, very accretive, profit-driving component of layers of sales through those average unit volumes over time.

Q - Unidentified Participant

I just had a couple of quick questions on grocery. First, take-up growth has been very robust. But this year with the new entrants coming in, both private label and craft, growth has slowed a little bit. Still at high levels. But it's slowed. I just wonder what you anticipate in terms of trajectory there.

Then the second question has to do with price increases at grocery. Typically, as green coffee would go up, you would see that pass through at grocery. But you're in this unique situation, I think, relative to the way this category has usually worked, in that you're totally hedged for this next year. So would you anticipate prices going up or sort of staying flat?

A - Troy Alstead {BIO 5724238 <GO>}

Let me first talk about take-ups, your first question. Yes. The category of single-serve. And then very specifically in the U.S., dominantly driven by take-ups has been rapid expansion. Starbucks, since our entrance into that space a couple years ago, has grown rapidly and far outpaced the category growth.

What we've seen in the last year or so is some slowing in category growth. And I think that isn't any recognition of anything other than it's a rapidly moving upward curve that is naturally going to have some slowing to it over time. We believe category growth continues. And we have Starbucks continuing to, over periods of time, gain share and grow faster than that category. We would anticipate that to continue, by the way. Not necessarily every 4-week period, based on promotional activity or what may be happening with launches in that period of time. But over a much more meaningful 13; and 52-week period of time.

We believe we've got upside to share. We are the leading share holder in premium single-serve and in premium take-up. And believe we've got some upside to that yet to go. Now, with that said, that's not to at all discount the proliferation of take-ups in the space. That will continue. I believe ultimately, the single-serve space will be as competitive as packaged coffee is today, where there's a wide variety and quite a (tiering) of pricing down the aisle. That's beginning to flush out much more and that will just continue to mature.

We're quite confident in our ability with our brand, with continued choice to customers, with expansion of skews that we can make available. And that we will be adding very soon under the take-up platform, that we can continue to earn our way into outpacing category growth and building share in that space.

Then pricing, if I could speak to, is we had the great advantage in the last cycle a few years ago of waiting a bit longer, as everybody else went up in prices down the aisle, to hold back our pricing a little bit. The net benefit of that is, we gained some share during that period of time. And we've been able to hold and build share since then. That was a very wise choice of ours. We ultimately did go up some. But we're able to be much, much more moderate on our pricing down the aisle.

We sit today even better positioned than we were two years ago. As Scott said, in the last cycle, we have twice as much forward price production today as we did back then. That gives us, we think, the luxury to really think through the right pricing strategy down the aisle, to use this as an opportunity to be consistent with the other pricing actions if we choose to.

We're also being very thoughtful about the appropriate times to use this as an avenue to gain share, to make sure we're still premium positioned down the aisle. But to gain share if we need to. I think there's nobody else out there, we think that's as positioned as we are as we head into this cycle.

Q - Joe Buckley {BIO 1491816 <GO>}

Troy, it's clear that Howard as the entrepreneurial gene. Since you're really running a good chunk of the company, do you need to have an entrepreneurial gene also?

A - Troy Alstead {BIO 5724238 <GO>}

Let me just say Howard is 23 steps from my office. That hasn't changed with this new org structure. So he's very, very close. He's not in the least bit stepping out of the company. I think it's very, very important to say that. He is as active and is spending as many seconds in the business every day today as he ever was. I think that's an important message nobody should lose sight of.

And what my role has the chance to do is complement what he's doing and what the rest of our leaders are in the organization, around adding some depth of focus around execution of the business. Starbucks has within it, you're right, a very deep, creative entrepreneurial DNA. It starts with Howard. But it doesn't end with Howard. I think it's important to note that he has focused on for a long time, as has our Board, deepening that DNA within the company, enriching it, fostering it, developing it, in a way that extends beyond. He is a very profound and very active leader in the company. That's the best answer I can give you.

Q - Joe Buckley {BIO 1491816 <GO>}

So do you share some of that DNA?

A - Troy Alstead {BIO 5724238 <GO>}

I hope after 22 years of Howard, a little bit's rubbed off on me. Let me put it that way.

Q - Joe Buckley {BIO 1491816 <GO>}

Because it's not just the managerial function --

A - Troy Alstead {BIO 5724238 <GO>}

I understand.

Q - Joe Buckley {BIO 1491816 <GO>}

-- the way you describe the company.

A - Troy Alstead {BIO 5724238 <GO>}

Absolutely. I appreciate that. And I understand the question. And I would like to think that in the company we have many people and I aspire to also be able to be one of those leaders in the company that can complement and support Howard as he continues to drive creatively in the company.

Q - Unidentified Participant

(inaudible) mobile ordering? What's next for Starbucks?

A - Troy Alstead {BIO 5724238 <GO>}

Absolutely. Some good things are next. So right now we're evaluating. And this year we'll be testing a couple of forms of potential mobile ordering. One would be an ability to actually order in advance. So before you get into the store, an ability to place your order and have it read when you get there. Another would be express order and pay, which is once you're through the threshold of the door, an ability to skip the line or go through a different process and get your drink that much faster.

And we're looking at that. We're testing all that. We'll probably -- we will launch in a major market this year to thoroughly test that. Then the plan would be to fully roll that at some point nationally next year.

Lots of operational things to work out, lots of things to understand, particularly with advanced ordering, making sure your drink is ready and fresh when you get there. But that's what the significant test will help us to iron out.

Q - Joe Buckley {BIO 1491816 <GO>}

Could you give us a brief update on China? A lot of noise (around) other companies, business in China recent months. And can you just put that in perspective for -- (put) Starbucks in perspective, given that backdrop?

A - Troy Alstead {BIO 5724238 <GO>}

Yes. China has been an amazing growth progression for us. We've been in China for 15 years now. The unit economics, the growth rate, the acceptance in the marketplace, the strength of the brand are at phenomenal levels. Our margins are as high or higher there than anywhere else in the world. The return on capital as we deploy it into our development in China is very, very powerful.

And while we are well aware of the backdrop of what we're hearing from other companies out there, if all I could do was look at our business and understand what's happening on our daily transactions and our comp growth and the progression of the (wealth of) opportunities we have, I would have no concept, frankly, that there's anything happening beyond.

And I think that speaks a little bit to, while we're well over 1,000 stores in the mainland now, we're still smaller than many other systems. We have a very premium brand that enjoys a very, very high level of appreciation in the marketplace. I think all of that's giving us, perhaps, some insulation, some protection from what might be some of the macro bumps that others are experiencing.

Our trajectory continues unabated and we have big, big plans as we progress through the next few years in China.

Q - Joe Buckley {BIO 1491816 <GO>}

Part of the turnaround and the great performance in Starbucks was driven around operational efficiency. Where are you on that front? Have you done all you can do or is there more to come?

A - Scott Maw {BIO 18637895 <GO>}

Yes. I mean, I'll start with the supply chain that Troy talked about, then I'll go in the store. And Troy can add on.

I think in the supply chain, we have built over the last handful of years an ability to drive efficiencies within the supply chain. And so we have, every year within our planning process, we set a target of savings for the supply chain. We stack opportunities against it. And that organization does a great job going and getting us that savings.

What we see in the near term is an ability to sort of step change that. So we built that muscle. We've got some new leadership in the supply chain, a new leader in the supply chain that we're partnering with, to really increase the breadth and depth of those operational opportunities. We've got the experience to do it. And we think that that could step change perhaps as much as double over the next year or two, the supply chain savings that we can drive.

In the stores, I think we are constantly improving our operational and execution capability in the stores. We've seen comp sales growth in all day parts, even in the morning and peak parts. And so we have seen productivity increase over time through some of the things that we do in beverage routines behind the stores, through some of the things we do in getting better at certain types of staffing and certain types of functions in the stores. So that's something we continue to invest in, not just with things like the La Boulange rollout. But in ongoing core things around our beverage execution.

Q - Joe Buckley {BIO 1491816 <GO>}

Okay. I think that wraps up our session. Troy, Scott, thank you very much. Appreciate it.

A - Troy Alstead {BIO 5724238 <GO>}

Thank you.

A - Scott Maw {BIO 18637895 <GO>}

Thank you.

A - Troy Alstead {BIO 5724238 <GO>}

Thanks, everybody.