Jefferies Global Consumer Conference

Company Participants

- Troy Alstead, CFO, Chief Administrative Officer

Other Participants

- Andy Barish, Analyst, Jefferies
- Unidentified Participant, Analyst, Unknown

Presentation

Andy Barish {BIO 1512077 <GO>}

Thanks a lot. We will keep things moving along this morning with the leading specialty coffee retailer in the world, Starbucks. Very pleased to have Troy Alstead, the CFO, looming behind me here. And JoAnn DeGrande, who runs the Investor Relations function at the dais, or table, or whatever we want to call that.

The Company has had a very significant run since some challenges that they addressed very quickly and swiftly in the downturn and recession. And I think probably puts Starbucks, which as many of you know has been a remarkable growth story, on more solid footing than at any time I think I can remember in terms of just core fundamentals in terms of the top-line profitability and growth. And with that, I will stop and let Troy tell you the real story.

Troy Alstead {BIO 5724238 <GO>}

Thank you, Andy. Good morning, everyone. It is great to be here. The store behind me is a store that is opened about a year and a half ago in -- south of Seattle. It is in the industrial area near the Port of Seattle. It is made from four reclaimed shipping containers. It is LEED certified, as are all of our -- the goal for all of our new stores to be built going forward. This is a highly profitable drive-through store with also a walk-up window. And many people use it as a bike-up window, as well.

It is in a great location. It has won many national and international design awards for the innovation of this design. And it is an example of our ability to continue to innovate against the store concept, the store design, while we also innovate against beverage opportunities, food and everything else we do in our business. So a very good reflection of the growth opportunities we have to come. Incidentally, if we ever had to relocate this store, that would be quite easy to do.

Starbucks has always been a growth company. Since the early days as a privately-held company and then over the last two decades as a publicly-traded company, we have been defined as a growth company, largely during that period of time by growth in new stores. And particularly for much of that history, growth in new stores within the US.

Since the difficulties of 2008 and 2009, we have really diversified and matured our growth strategies, crafted a whole new set of strategies and plans and initiatives around driving growth multidimensionally throughout the business. And I will spend a little bit of time this morning taking you through a few of those, what we believe to be the most significant opportunities we have.

We are targeting to deliver 10% or greater revenue growth on a sustainable annual basis. In 2012, we delivered revenue growth of 12 -- of 14% -- excuse me. In this current fiscal year, fiscal 2013, we anticipate by the end of the year driving revenue growth between 10% and 13%. And I think by the time we get toward the end of the year here, we will be right somewhere in the middle of that range.

We are also targeting leveraging that 10% revenue growth into more rapid earnings growth as we expand margins over this period of time, targeting 15% to 20% sustainable growth in earnings. And over the past three years, we've delivered compound growth rate and earnings of 19%. So toward the top end of that sustainable range that we are driving for. And in this current fiscal year, our current-year target ranges between 18% and 22% earnings growth, with a significant number of investments we are making back into the business this year to drive growth in future years. Then benefited a bit by commodities favorable this year, after a few years of some difficulties in commodities, that is helping boost us toward the top end of that range and perhaps tipping a little bit beyond that 15% to 20% range that we have targeted.

Now, the opportunities that we face are multiple. And they include the traditional store growth that we've historically executed very well. But also a range of those. And I intend to take you through a few of those highlights today, starting with food. Food ranges around the world within a Starbucks store from a low end of about 10% of the sales mix in some markets around the world to a high end nearing 30% in other markets around the world. In the US, food is about 19% of the sales mix within a store. Approximately 1/3 of our transactions in US stores have a food item on them. Two thirds of those transactions do not have food on them. And that really represents the opportunity as we see yet.

Of those two thirds of the people, 50 million to 60 million customers coming into our stores every week, many of those two thirds of the people want food. We've already acquired that customer. They've come in the store. They are interested in food. They are ready to give us money. And yet the barriers historically to us capturing more of that two thirds have really been twofold, as we understand our customer.

One has been our food often historically has not met their expectations. It has not been up to the quality they expect when they come into the Starbucks. The second barrier has been it hasn't always matched the occasion. So the daypart. In our early days, our food was primarily oriented toward that morning daypart. We didn't have lunch offerings. We didn't have something that was appropriate in the afternoon if a customer was coming in.

Over the last several years, we've really significantly addressed and continue to address both of those barriers by elevating the quality of our food, by improving the execution in the store and also by increasingly innovating -- just as we do with beverages, innovating against the dayparts, going after that midday daypart. Innovating with food into the afternoon and evening, where we know in those dayparts, food is a more meaningful driver of that customer's decision to come in the store than it is in the morning, where it is primarily a beverage-focused transaction.

The result of that has been not that many years ago food being in the low teens as a % of sales in the US, with a much lower attach rate. We have slowly. But surely, been addressing the barriers to that customer purchase and moving that sales mix and that attach rate higher. And that is all before the La Boulange acquisition.

What has encouraged us going forward is the early results of our new food program, starting with bakery with the La Boulange execution first in the Bay Area, more broadly in Northern California, very recently in the Seattle market, as we just launched there a week ago; and then we will continue launching this new bakery program city-by-city across the US over the balance of this year and for about the next 18 months before we are fully penetrated.

The confidence we've had from what we've done with food in years past and the early -- very early results we are seeing in our new markets with La Boulange gives us confidence in our ability to continue driving that attach rate higher and driving the sales mix in food higher.

What is important about food is it has two opportunities here. One is to attach more food to those existing transactions, those customers who are already in the store. But we also know that food can be a driver of traffic. It can create an opportunity for somebody to come in in the afternoon at midday when perhaps otherwise they would have made a different choice. And better food also sells more beverage. So we see a tremendous opportunity here with food as a consistent driver of growth over time.

Now, as excited as we are about food, the core -- the largest part of our sales mix, the core of our business and where we have significantly continued to innovate is within the beverage category. Just in the Second Quarter alone, we had three points of incremental comp coming from new beverage innovations, three particular products, shown here actually. The Refreshers platform, which was an entirely new platform -- not just a product, a platform of products that we launched for the first time last summer. It is going after an entirely different consumer need state, that refreshment category that we had not historically really addressed in our portfolio of product offerings. It really targets an entirely new daypart. It helps stretch people into that underleveraged time of the day when we have significant opportunity. And by itself, added about a point of incremental comp in that Second Quarter that we just reported.

I also list up here two other beverage innovations that are right in the heart of what we do, Hazelnut Macchiato and Vanilla Spice Latte. I call out that in particular because together, they give us about two points of incremental comp in that Second Quarter. But particularly to make the point that those espresso beverages are right down the middle of where the largest part of our sales mix is within the store, in that espresso category. And it is even in that large, very mature, very established category within a Starbucks store, we continue to innovate and clearly continue to have opportunity to drive incremental volumes through the stores, very profitably, with beverage innovation.

I mentioned the store upfront. And I will comment on stores here again. Now, our store opportunity going forward is both as we remodel stores. This is a Times Square store that we remodeled about a year, year and a half ago. It is the number one volume store in the US for us at about $6 million AUV. And it is representative of our ability to take existing stores and either remodel and in some cases expand where that opportunity exists, create a significant brand platform and drive significant volumes through those stores.

Now, not every location in the country or in the world is a Times Square kind of traffic location. Our second-highest volume store is the Pike Place store in Seattle -- 1200 square feet, a limited offering. There is no food offered in the store. It is really the original of the concept only with beverages in the store. And yet this is a $5.5 million AUV that continues to comp very strongly. Profitability, four-wall cash profit in the store is in the upper 30s. It is a very good representation of our ability through a relatively small footprint to continue to grow and innovate and drive continued traffic over time.

The third highest-volume store in the US is traveling all the way down to Houston, where we have this drive-through store. It is a beautiful store. It is an extremely high-volume store. And it is reflective of our opportunity as we go forward about adding drive-throughs increasingly into the mix. About 40% of our US portfolio today is in drive-through stores. Going forward, our growth in new stores in the US will be about 60% drive-throughs or greater, as we continue to recognize an ongoing opportunity to get better at how we operationalize through the drive-through and then also how that opens up new real estate opportunities for us.

By the way, we are increasingly looking at drive-throughs in selected markets around the world where we are highly underpenetrated. But recognize we have a significant opportunity.

Now if any of you have ever traveled between LA and Bakersfield, California, you will know there is not a whole lot there. But right in the middle of that stretch there is a Starbucks drive-through store. That is in the top five volume stores in the US for us as well. And again, represents and underscores the opportunity for us with drive-throughs. But also increasingly, as we have sharpened our abilities around our supply chain into our stores, as we've deepened our capabilities around operating profitably, as we've increasingly managed our ability to select sites and execute those sites, it has opened up for us increasing opportunities for real estate. And it represents an example of why we continue to believe that even in the US, where we have obviously our longest-standing marketplace, the most stores anywhere in the world, that we continue to add hundreds of new stores per year here within the US, both by adding depth within the existing trade areas and in many cases reaching into new market opportunities that we couldn't have reached historically.

In the last several years in particular, really since the challenges of 2008 and 2009, we have significantly deepened our capabilities around real estate site selection, around understanding trade areas, around store design, around innovating around the concept. We've become much better operators of stores within the stores, about managing waste and managing and deploying labor. We've become much more selective about how to size a store for a particular trade area. We understand cannibalization than we ever have before. And that has opened up all kinds of innovative depth of opportunities for us, including a ski-up store that you see here in one of the ski areas, including a store that will open up here in a few months. It is a train car that is actually in the Swiss train system, an entire Starbucks store that will travel with that train. And we are very excited about that opportunity. And is reflective of our opportunities in the US and around the world.

Now, tea is the second most consumed beverage in the world, second only to water. It is an ancient beverage and yet at the same time it is a beverage platform and category that has many new, innovative, exciting things happening with it in the US and around the world, as there is a bit of a revitalization in consumers' interest around tea, recognizing its health and wellness benefits and the aspects of tea. And with all that said, tea for Starbucks has remained in the single-digits share of sales within a Starbucks store.

Now, tea has been in the name of Starbucks when we opened the concept, Starbucks Coffee, Tea & Spices, way back in 1971. We have equities in this space. We have customer permission in this space. And yet it has never had the focus and attention in our stores and outside of our stores that we can now bring to it.

We are very excited about tea as an opportunity in our stores. And the Teavana acquisition that we completed just recently brings with it three propositions, three growth opportunities. One is to continue rolling the Teavana store out, by bringing together the deep capabilities that Teavana team has in tea sourcing and blending and R&D that they are very deep and strong in, as well as their merchandising capabilities within the existing Teavana stores. And combining that with what Starbucks does well, store operations, store design, labor deployment, site selection. And importantly, beverage execution and innovation.

A new generation of Teavana stores will begin opening up this fall, will look and feel much like Teavana of old. But will bring with it new elements of beverage execution and innovation in the store that we believe will add a new layer of growth and open up significant growth opportunities for the Teavana standalone concept in the years ahead. We are very excited to begin rolling that across the US, again, starting in New York beginning this fall. And ultimately, there is tremendous opportunities we know around the world for a contemporary teahouse concept that we believe we can execute quite effectively.

The second strategy and leg of growth for tea for us is to now deepen our tea presence within the Starbucks stores, or really use tea as a driver of another customer occasion, another customer visit. It is a very complementary consumption time to coffee. Coffee to the American consumer tends to be busy and rapid and skewed toward the morning. Tea is a little more relaxing and Zen-like and skews to the afternoon and evening and weekends, very complementary to that existing asset we have. With Teavana's capabilities around tea and our ability to bring beverage innovation in a focused way to tea, just as we have to coffee and now to food, we believe we have an increasing opportunity to use tea as another layer of growth within the Starbucks store over time.

Then the third opportunity with Teavana, in particular, is to use that as a leverage point into CPG channels over time. Once we establish the brand more meaningfully, create awareness through the Teavana stores and through the Starbucks stores, we have an opportunity to then extend that, both in dry tea and ultimately perhaps ready-to-drink tea and other tea innovations in a packaged format into the CPG channels over time.

Another opportunity and geographically was China Asia-Pacific for us. Our CAP region is the fastest-growing region of the world for Starbucks. And it is also the highest margin and highest return on capital region of the world for us. It continues to be a significant opportunity.

And in China, which gets a great deal of airtime and is a huge opportunity and will very soon become our second-largest market anywhere in the world. But also in India, a market we just opened a few months ago and are seeing tremendous early results from. Vietnam, also a new market we opened. Indonesia, a place we've been in for many years now. But has significant long-term opportunity, both in store development and then outside of the store. Products like ready-to-drink beverages, for example, we have a significant opportunity in many of these Asian markets to deepen our presence and expand the Starbucks reach into the consumer through our brands and products and channel opportunities.

Speaking of channel opportunities, channel development is a part of the business that consumers have told us too over the years -- with the deep history of Starbucks, as you know, being in the Starbucks' store, we have come to recognize more strategically over time that there is a significant opportunity to go after customer occasions of our brands and products and the offerings we have outside of that Starbucks store. That is largely focused today in the US, with all of our products around packaged coffee, singleserve, ready to drink, VIA, many opportunities within that core of the coffee and tea space and some adjacencies right around that that we are profitably developing and growing within the US and increasing outside of the US. It leads us to believe that in the next five years, channel development will be among the fastest-growing parts of our business anywhere that we have, as we continue to extend, again, our reach to the consumer outside of the traditional Starbucks store.

All of that growth really empowered by what we do digitally. We've had significant success in reaching our customers digitally, significant benefits both in terms of cost. But also the halo that comes from providing these opportunities around payment methods and loyalty to the customer. The Starbucks card in all its entirety. And that means the physical card. But also mobile forms of card -- store value card payments represents now greater than 30%, almost 1/3 of transactions in our US system.

The loyalty program in the US just introduced a couple years ago represents now 25% and rapidly growing of our US transactions. Mobile payment, not launched all that long ago, represents greater than 10% now of our US transactions. A significant opportunity to, again, continue to drive efficiencies, speed of service, a lower cost transaction within our store, a very sticky transaction by virtue of the fact that people have preloaded their money that we hold for them in anticipation of that coming transaction. And increasingly, an ability for us to harvest that information and really determine the most effective ways over time to understand our customer, to target products toward them and, in the appropriate ways, reach them with our messages.

All of that again represents a snapshot of where we today see our most significant growth opportunities. There is many more beyond that. But perhaps I will pause at this point and hand it back to you, Andy, for any questions or any questions that you may have.

Questions And Answers

Q - Andy Barish {BIO 1512077 <GO>}

Sure. I'll kick things off. I was actually shocked to see the China food number at the bottom on the list. I thought -- if my recollection serves me correctly -- when you originally opened in that market, it was mostly an afternoon tea time food business. So can you kind of give us an update? It seems as if maybe the coffee culture is starting to take hold in China and it has obviously become much more of a beverage business.

A - Troy Alstead {BIO 5724238 <GO>}

Well it has always been skewed toward a beverage business. But when we've opened up in China, the dayparts were, yes, skewed more toward midday and into the afternoon, with a very low, almost nonexistent morning occasion.

What has happened over time is, yes, the beverage business has grown, the awareness of Starbucks' products and that learning and that experience around how to ask for a Starbucks beverage and how to enjoy those beverages and how to use the Starbucks concept, all of that has grown over time. And yes, that has more pronounced driven the beverage business in our stores, which is very critical to our concept. It has also driven the morning a bit faster, where we really see that morning experience developing increasingly in China. We actually see the opportunity both to drive AUVs in China through food, through dayparts, through the frequency of that visit. But also increasingly through our beverage innovation and the attachment of food to it over time.

Q - Andy Barish {BIO 1512077 <GO>}

And can you give us just a quick update on China unit economics, sort of trendwise? Are you seeing any -- as the Tier 1 cities get a little bit more crowded and competitive, are you seeing any changes in that, good or bad?

A - Troy Alstead {BIO 5724238 <GO>}

We are still small and fairly early in our experiences in China. We've actually been in China since the late '90s. But we reached something of a tipping point, I would say, three or four years ago, where all these classes of stores really significantly elevated in terms of comp growth and volumes through those stores. I think that was about reaching an awareness in that marketplace.

In our early days of extending then from the Tier 1 cities into Tier 2 and Tier 3, in those early days of development, we saw very similar economics and sometimes stronger economics in Tier 2 and Tier 3 cities than we even saw in the more mature Tier 1 cities, as we were selecting, as you would expect us to do in the early days of any market entry, some of the best real estate in the market.

Now as we progress over the next many years, we do expect that we will likely have very, very strong ongoing economics within China, probably somewhat moderated from where they've been in these early days, where we are largely cherry picking the right kinds of real estate. But with that said, we fully expect. And we see today, that the unit economics in China likely will always be the strongest at a unit economic level for us anywhere in the world.

The volumes remain lower than, say, in the benchmark US business. But four-wall profitability and four-wall return on capital is very strong in China. And we would anticipate that pattern to continue even as we penetrate within Tier 1 cities. And again, outside of the Tier 1.

Q - Andy Barish {BIO 1512077 <GO>}

Thanks. Maybe your perspective as; you didn't spend a lot of time; but on K-Cup growth. First of all, maybe a quick snapshot of the new Green Mountain deal that you signed recently.

Then secondly, from a big picture, strategic perspective, is there a -- I guess a tipping point, to use the term you just used? At some point with the growth in singleserve, do you worry about consumption in the retail coffeehouse business? Or how have you looked at those occasions over, say, a five-year period?

A - Troy Alstead {BIO 5724238 <GO>}

Let me speak to the last part first. The answer to that is a profound no. Customers don't make a trade largely between their at-home consumption and consumption on the go, in a coffeehouse, whether it is a Starbucks coffee house or somebody else's. Perhaps around the edges some do, by the way. But fundamentally, that is not a trade customers make.

What we see as a significant opportunity -- and I think, in fact, that point is evidenced by the fact that over the last several years, as there has been increasing attention to at-home consumption, on our part and on other people's parts, in making consumption more convenient and easier at home through, for example, most significantly the Keurig platform, there has been nothing but significant growth within the Starbucks stores. There really is no meaningful transaction there.

What we do have every aspiration to do is elevate our share of at-home consumption. While Starbucks has a nice share of coffeehouse consumption in the US and something we'll continue to deepen, we believe, over time and have opportunity to grow even further, we've always been underrepresented in at-home coffee consumption. And when historically we've asked customers why that is; if you are a loyal Starbucks customer, why don't we get more of their share of consumption when they are at home; historically, it is because we weren't in the form factor that they were looking for at home. And that has led us over the last several years to really aggressively innovate into this space, providing more at-home opportunities in packaged coffee, Starbucks high-quality flavored coffees, increasingly things like VIA. And then a couple years ago on the K-Cup platform.

Most consumption at home in the US is in the low pressure brewed category. So our Green Mountain with Keurig have done a fantastic job placing their machine into people's homes. The beauty of that platform is it is a very healthy economics for everybody in the business in singleserve who can make a proposition of it. But importantly, as coffee becomes easier for people to consume, people consume more. So we are actually seeing higher consumption of coffee, largely, we believe, driven by singleserve executions.

Our strategy, both in the Keurig platform. And really respectfully with all forms of singleserve in the US and around the world over time, is to be the coffee on other platforms. We recognize that Starbucks is not an equipment company. We don't have aspirations to become a deep equipment company. We have a fantastic partnership with Green Mountain, who, again, has done an outstanding job placing their machines in millions of people's homes over time.

And that relationship and partnership and what we believe to be the opportunity going forward led us to, together with Green Mountain, lengthen and expand our relationship, to more SKU count, to a longer term, reflecting where this business is going. They are an extremely innovative company, always things on the table for innovation around that singleserve beverage experience at home that we want to be a part of together with them. And that is what led us to, together with them, extend that relationship.

Q - Andy Barish {BIO 1512077 <GO>}

Questions from the audience? Yes.

Q - Unidentified Participant

(inaudible; microphone inaccessible)

A - Troy Alstead {BIO 5724238 <GO>}

Yes, some of both. You're right; the historical Teavana concept, which has great unit economics and is something we are very happy with, was largely a mall-based merchant, a mercantile, a retail execution of hard goods and dry goods. Going forward, we will very much respect that, because there is fantastic economics. And that's a great experience for the consumer in that execution.

But what we are working together with the Teavana team on is bringing more of a beverage execution into it. Again, because our Starbucks capabilities are so strong in how to operationalize beverages and how to innovate around beverages, we'll add that as a layer into the store.

Now, the dry goods and hard goods I expect will always remain a predominant part of that Teavana sales execution and the experience of that store. But we know we can add both a layer of sales and profitability into the store by making it a contemporary consumption tea beverage, teahouse kind of place. But also by having a more pronounced beverage execution in-store, we think that will accrue to more sales of the hard goods in the stores as well. So the new, somewhat evolved concept is what you will begin seeing roll out this fall.

Yes?

Q - Unidentified Participant

(inaudible; microphone inaccessible)

A - Troy Alstead {BIO 5724238 <GO>}

Now, we don't --

Q - Andy Barish {BIO 1512077 <GO>}

Troy, can you do a quick paraphrase of the question, just for the webcast?

A - Troy Alstead {BIO 5724238 <GO>}

Thank you. So the question was is there any backlash -- if I represent it correctly -- or concerns we have about regulations around caffeine or the FDA's interest in that space, or some of the things I think others have gotten in trouble with a little bit around high caffeine content.

And the answer is no. We watch it extremely closely and always have. But if you step back and really watch Starbucks, we have never significantly targeted high-energy kinds of beverages. We've never made a point that we are going after the youth market with caffeine beverages. We've been very cautious representing what our concept represents.

Coffee and caffeine is one of the most steady beverages for centuries. In fact, it has been around a long time. We are quite confident that in the right use among our customers and the way we are targeting that it that it is a very complementary, healthy beverage and not something we are concerned about with any regulations around. And again, I think it is largely about how we positioned our brand and our products historically and how we intend to position it going forward.

Q - Unidentified Participant

(inaudible; microphone inaccessible)

A - Troy Alstead {BIO 5724238 <GO>}

The question was -- for those who couldn't hear it -- I mentioned a lot of opportunities. What is the biggest challenge we face. And how will we overcome it?

I think no question the challenge we face and talk about together among the leadership team and with our Board frequently is around execution of all those things. We have significant opportunities. We have a very, very healthy and robust business today in the US. We have a growing and increasingly profitable business outside of the US. There are significant opportunities as I've gone through outside of the Starbucks store.

Our opportunity and our challenge is to execute effectively and stay on top of those as we go forward. It is an area where we focus heavily. I'm quite confident in our ability to do it. We have a deeper, stronger management team than we ever have had in our history. We are far better today at allocating the depth of talents and resources against each of these initiatives.

I started at Starbucks when we were privately held more than 20 years ago. Back then, everybody did everything, because that was what; not unlike most startups around the world, that is what you do in those days.

Starbucks is a dramatically different company today. We have depth of talent and specialists who are targeted and bring experience against each of these initiatives. Then we watch them and report on them and measure them closely.

So I would say execution is our biggest challenge. But it is something I am quite confident in our ability to continue executing and delivering.

Q - Andy Barish {BIO 1512077 <GO>}

I think with that, we will wrap up the session with Starbucks. Thank you very much for your time.

A - Troy Alstead {BIO 5724238 <GO>}

Thank you.