Goldman Sachs Global Retailing Conference

Company Participants

- Pat Grismer, Chief Financial Officer

Other Participants

- Katherine Fogertey, Analyst, Goldman Sachs
- Unidentified Participant

Presentation

Katherine Fogertey {BIO 15247533 <GO>}

Thank you for joining us here today. We're joined with that Pat Grismer. He is the CFO of Starbucks. I'm Katherine Fogertey, the restaurants analyst. And we're very lucky to have Pat here today. So he has a very rich history in restaurant and consumer broadly. He just joined Starbucks about a year ago as the CFO, but prior to that, he held a role as CFO of Hyatt, CFO of Yum!, and also spent a good amount of time at Disney. So good mix of consumer, restaurants and iconic brands for sure. He will start off with a presentation and then we're going to go to some prepared Q&A I have on my end, and then we look forward to opening it up to questions from the group. So with that.

Pat Grismer {BIO 15965217 <GO>}

Thank you, Katie, and good morning, everyone, really privileged to be here with all of you today. There are a couple of key messages that I'd like to share ahead of our fireside chat, if you will. The first is to highlight the strength of our results in fiscal '19, and the second is to clarify the broad implications of our fiscal '19 performance for our preliminary outlook for fiscal '20.

First, I'd like to acknowledge our safe harbor statement here, as I will be making some forward looking statements. So starting with our performance in fiscal '19, we are extremely pleased with our results this year, with our non-GAAP EPS up about 16%. That's the midpoint of our current guidance range. And we believe that this performance reinforces the strength of our growth at scale agenda, which we are executing with focus and discipline.

And as a reminder, that agenda has three key pillars. The first is to elevate our lead growth markets in the US and China. The second is to extend the global reach of our brand, notably through our global coffee alliance with Nestle. And the third is to increase shareholder returns.

So as to that 16% non- GAAP EPS growth, that is well ahead of our original guidance, 9% growth at the midpoint. And you can see here the key drivers of that out performance, starting with better-than-expected performance of our core business through a combination of better-than-expected global comp sales growth, as well as improved margin management that contributed 4 points of incremental EPS growth.

That was slightly offset by 1 point of dilution from our Siren Retail business as well as 1 point of dilution from corporate G&A. You can see as well that we faced an incremental 1 point of headwind from foreign currency translation. But you can see that, far and away, the driver of our out performance in fiscal '19 relative to our original expectations was our effective tax rate. And that has significant implications for the shape of our growth in fiscal '20 as that out performance was largely driven by one-time discrete income tax benefits.

So in terms of what those implications are, you can see here the chart that starts with our original guidance or outlook for both fiscal '19 non-GAAP EPS growth as well as for fiscal '20. And this is as we presented it at our Investor Day last December. And then you can see in the next four lines the individual items contributing to this year's out performance and the corresponding implications for fiscal '20. So, taking each one of these in turn, starting with our operating results.

Again, strong operating results this year, we expect that to sustain. Our operating growth model is intact and we feel very good about the steps we are taking to drive, both top line performance and bottom line performance. And I reaffirm what those components are" top-line growth in the range of 7% to 9% and operating income growth in the range of 8% to 10%.

As to the tax rate, again, given the onetime nature of the benefits that we realized in fiscal '19, you can see that it's a very significant headwind to our EPS growth in fiscal '20 as we lap those benefits. And then, with respect to share repurchases, we elected to pull forward about $2 billion worth of share repurchases that we had originally planned for fiscal '20 into fiscal '19. And the context for that is that, in the last year, our share price has increased by more than 80%.

So in the context of a rapidly appreciating share price, and given that we had liquidity to do it, we pulled forward those share repurchases and were able to preserve what we had expected by way of an EPS growth contribution from share repurchases net of the associated interest expense. And with that pull forward, then, there will be lower aggregate share repurchases in fiscal '20 and the associated EPS benefit net of interest expense on the debt issuances this year, as well as what we expect to issue next year, will be tempered relative to our original expectations.

So you add all of that up and what that means is that for fiscal '20, our EPS outlook is below our ongoing growth model of at least 10%. But again, I want to reinforce that our growth at scale agenda is delivering against our expectations. I would say that we're firing on all cylinders from an operating performance perspective with the focus and discipline necessary to drive growth at scale for a Company like Starbucks and our long term double digit EPS growth model is fully intact. But again, we do expect an EPS growth outlook for fiscal '20, that is meaningfully below the ongoing algorithm that we had laid out at our Investor Day.

And so, with that, I'd like to turn it over to Katie to lead us through fireside chat. And then, as Katie mentioned, happy to take questions from the audience. Thank you very much.

Questions And Answers

Q - Katherine Fogertey {BIO 15247533 <GO>}

Great. Thank you. So Starbucks is one of those amazing large companies that has such strong ties to the macro. You are benefiting from record low unemployment rates, very strong wage growth. Just curious, what are you seeing right now from the consumer, boots on the street? How is the consumer behaving right now?

A - Pat Grismer {BIO 15965217 <GO>}

We see in the US a very healthy consumer. As I mentioned before, we're very pleased with our operating performance in fiscal '19. We recently raised our guidance for comp sales growth, given the strength of performance in the first three quarters. We track very carefully the APT restaurant index to understand what's happening in the industry from a sales and transaction perspective. And I'm thrilled to share that in the last four quarters, Starbucks has outperformed that index from a sales perspective, in the last three quarters, outperformed from a transaction perspective. So we are seeing a healthy consumer in the US, but also we are seeing out performance for Starbucks on the strength of what we are doing to drive and improve customer experience, to lead with breakthrough beverage innovation, and then, to supplement with compelling digital initiatives.

Q - Katherine Fogertey {BIO 15247533 <GO>}

That's great. Actually, it tees up to my next question. You guys had a very strong cold platform a couple of years ago and that struggled as consumer preferences changed. You spent a lot of time developing a new cold platform. We have Nitro now in almost all of the stores. Curious, the strength, especially with that 7% comp that you reported last quarter, how much of what we're seeing right now is early success on cold that is repeatable going forward versus strong macro? How would you distinguish the two?

A - Pat Grismer {BIO 15965217 <GO>}

Well, a strong macro certainly is contributing to our performance this year, but as I mentioned, there are things that are unique to Starbucks, that are driving our out performance versus the industry generally. And I mentioned breakthrough beverage innovations as one of those. And I would highlight within that the unique strength of our cold beverage platform. As you mentioned, in recent years, we had seen a decline in our cold beverage platform, largely because of the declining consumer interest in our frappuccino line, seen as a very indulgent beverage.

And to your point, as consumer preferences changed, we saw the opportunity to pivot to something new, something different, something that was more relevant and that spoke to consumer's desire for a lighter offering. And so Cold Brew and more recently, Nitro Cold Brew, along with our refreshers line of flavored teas, have done extremely well, not only to help replace the frappuccino business that we had lost, but importantly, to drive improved traffic in the afternoon, which is where we had seen pressure in recent years. I would say what is different about this platform compared to the past is that, it is resonating with consumers in terms of the type of beverage they're looking for, something that has a very distinctive taste profile, but also is a lighter beverage, which satisfies what they're looking for from a wellness perspective.

And then the other thing is that, particularly with the advent of Nitro Cold Brew, which is a highly proprietary platform, we are now in a strong position to innovate around that platform to bring new taste, excitement and points of differentiation for our customers.

Q - Katherine Fogertey {BIO 15247533 <GO>}

Yes. We just saw the pumpkin cold brew of the Nitro. What is the exact term for that?

A - Pat Grismer {BIO 15965217 <GO>}

The Pumpkin Cream Cold Brew.

Q - Katherine Fogertey {BIO 15247533 <GO>}

So that to me, it seems like it will be a sign of innovation around that platform. I mean, it's still early in the launch, but curious if that reception has been any different?

A - Pat Grismer {BIO 15965217 <GO>}

We're very pleased with how our Cold Brew and Nitro Cold Brew platforms have been embraced by consumers generally. You'll have to wait for our Q4 earnings release to find out precisely how much consumers have rallied around it. But no doubt you've seen the significant social media and traditional media attention to what I like to call PCCB, Pumpkin Cream Cold Brew. And I encourage all of you who have not tried it, to go out and give it a try. It's really a sensational beverage.

Q - Katherine Fogertey {BIO 15247533 <GO>}

And then how should we think about, you had talked about a 1% comp lift on stores that had Nitro? As consumer awareness grows, how is that evolving?

A - Pat Grismer {BIO 15965217 <GO>}

The 1% you refer to is what we observed a couple of years back when we were first testing Nitro Cold Brew. It was part of a test market and that's what gave us confidence to proceed with the nationwide roll out. So as of the end of Q3, we were in 5,800 Company-owned stores here in the US, on track to achieve 100% penetration by the end of this fiscal year, which is into September for us.

However, in having crossed the 80% penetration boundary at the beginning of August, we went on air with Nitro Cold Brew for the very first time. So even as we were seeing Nitro contribute to our overall comp performance on the strength of our cold platform generally, bear in mind that through the third quarter, that was without the aid of advertising. So we start with the advertising at beginning of August, again, that was in the second month of our fourth fiscal quarter. And we're certainly seeing good response to that.

Q - Katherine Fogertey {BIO 15247533 <GO>}

That's great. One of the things about Starbucks that maybe not everybody fully appreciates is that, it is a business that runs on loyalty. So, you've talked about over 40% of the sales in your stores, Company-owned stores are coming from My Starbucks Rewards members. You do have a very strong My Starbucks Rewards platform, but you have a much stronger digital relationship moat out there. And so, I'm curious, how is Starbucks going to continue to grow the My Starbucks Rewards and what does that trajectory look like?

A - Pat Grismer {BIO 15965217 <GO>}

So there are several angles to how we look to further leverage the strength that we have in loyalty and overall digital engagement. As you know, earlier this year, we relaunched our Starbucks Rewards Program here in the US, with new tiers for redemption. And we've seen, as we talked about in our Q3 earnings call, tremendous customer acceptance of this new structure. So by continuing to innovate around the structure of the program, it creates increased appeal for those who aren't members of the program, who see the opportunity to earn and redeem more flexibly than before. So that's one way that is to continue to innovate around that program.

The other, to your point, Katie, is how we engage those customers who are not members, but are nonetheless digitally engaged because they give us their email address when they sign up to use Wi-Fi in our stores. That provides us an avenue to communicate with them, to tell them about the benefits of membership, to offer them promotions that will encourage them to come more frequently, and hopefully, through that experience, also to understand the benefits of being a member.

The last one I would highlight is mobile order and pay. And so about a year ago we opened up mobile order and pay to customers outside of the Starbucks Rewards Program. And what we have seen is that as customers have the opportunity to engage with us digitally for that type of experience, they come to appreciate the additional benefits that come with being a member and having all of the functions and features that you get through our app. So multiple ways of communicating with and engaging those digitally registered customers in ways that motivate them to become full fledged members of Starbucks Rewards. And we continue to see that as customers make that choice to become members, their spend increases because it allows us to understand better their unique preferences, their buying patterns, and therefore, to target our offers to what will resonate most with them.

Q - Katherine Fogertey {BIO 15247533 <GO>}

And so when we think about converting a digital customer to the MSR, clearly there's a number of benefits to bringing people onto the overall digital ecosystem in the platform. What is the conversion rate? And you don't have to give a specific number now, but do you see a large runway to improve that, are we running at a pretty stable rate for converting digital to MSR? How should we think about that?

A - Pat Grismer {BIO 15965217 <GO>}

Conversion has been fairly steady. I would say given the sheer magnitude of the digitally registered population, there's significant potential for us to continue to drive growth in membership and we have seen nice growth in membership. Here in the US versus prior year, we're up in the low-to-mid teens. That's annually. So we're seeing steady growth there, but as I mentioned before, relative to the size of the digitally registered population, much more opportunity for us to continue to drive membership.

Q - Katherine Fogertey {BIO 15247533 <GO>}

Great. So now for this part of Q&A, you have two very big markets. One is a lot bigger than the other, but you have China and the US. And so I thought it would be pretty interesting to sit here and compare and contrast several very important initiatives that you have going on across these two bases. So you touched on the US consumer being very strong. Anything in China that we should be aware of when thinking about that market?

A - Pat Grismer {BIO 15965217 <GO>}

Well, we are very pleased with the overall performance of our business in China. We have seen comps sales in last year taper. And that is consistent with what we're observing in the market generally, which is that, while the economy continues to grow at a relatively strong pace, it is less strong than it was two and three years ago. And certainly, we're seeing that show up in retail footfall. We're also seeing a much higher level of competition. I would say to a great extent, Starbucks has demonstrated in China the appeal of the premium coffee specialty retail category, and that has attracted a lot of competition, not just in coffee, but also in teas. So with that, there's more competition.

The final thing I would say that is weighing on the comp sales performance we're seeing in China is, our own development. So as you know, for many years, we have realized extraordinary returns in our new unit investments in China, on the order of 80% cash on cash return. So really quite extraordinary. And given the scale of the market and our strong premium positioning, we believe that we are very well positioned to capitalize on those trends and continue to grow at a very aggressive pace. But that does come to some extent at the expense of comp sales growth. So really a combination of those three, the economy being one of those.

Q - Katherine Fogertey {BIO 15247533 <GO>}

And are you seeing -- you hinted at cannibalizing your stores a little bit in new markets in China? Are you seeing that more of a problem for a Tier 1 city versus Tier 2 and Tier 3? How should we think about that?

A - Pat Grismer {BIO 15965217 <GO>}

Definitely a much stronger headwind in the Tier 1 cities where we are more heavily penetrated, where when we go in with new development, we are more apt to impact one of our existing units. But we do that knowingly. We do that intentionally because we're solving for the long term opportunity. And I would highlight that, in recent years we've continued to grow our total transactions in China in the double digits and we're growing stores in the mid teens. So we're playing the long game in China.

Q - Katherine Fogertey {BIO 15247533 <GO>}

All right. And just again, comparing the track mile here. Looking at the US where you guys have just a phenomenal footprint here, are you seeing similar levels of cannibalization when you put in new stores here as you are there? Is there any parallel to draw?

A - Pat Grismer {BIO 15965217 <GO>}

Less cannibalization here, in part because we're growing at a slower pace. So, whereas China, new units or net units are growing in the mid teens, our outlook for the US is in the range of 3% to 4%, which I think is still very strong for a concept of Starbucks' scale in the US. And what underpins that 3% to 4% growth rate is that there are still regions in the US where Starbucks is underrepresented largely in the center of the country and in the southeast, some parts of the northern plains. There's a lot of white space out there for us. And we're continuing to hope and in particular, drive through units which offer even better economics because they come with higher average unit volumes and a superior margin profile.

Q - Katherine Fogertey {BIO 15247533 <GO>}

Perfect. Now, on drive-through delivery, all this great stuff that would go side of the equation, you have a partnership with Alibaba in China. You have announced an exclusive with Uber Eats in the US. And I'm just curious the Chinese delivery market much more evolved and further along than in the US. You had been trialing delivery for a while, our survey all suggests that coffee is strangely, a very requested item for delivery. So that piques my interest. What are you seeing here across both markets on delivery?

A - Pat Grismer {BIO 15965217 <GO>}

Well, I'll start with China. To your point, the Chinese consumer is much more digitally engaged. So we see higher levels of pickup and delivery overall for China. And just to maybe level set, both the US and China for Starbucks are in their first year of delivery operation. So it's early days for us. And so we are rapidly learning and adapting the model as we go. But in China, we've seen much more rapid adoption of the delivery occasion. You mentioned our partnership with Alibaba. We could not be happier with that relationship and how they've supported us in our growth of the digital business, leading with delivery and now more recently with mobile order and pay. So another angle of our digital growth agenda in China, and we're seeing very rapid adoption.

Contrast that with the US, where we've had mobile order and pay for many years. And that has proven to be quite successful for us. In fact, I would say and perhaps many of you have experienced this during the peak morning hour in particular, mobile order and pay has led to capacity constraints. I suppose it's a high quality problem to have in retail where there's latent demand and the opportunity for us is to unlock the capacity so that we can accommodate all of that demand. But interestingly, in the US, as strong as mobile order and pay has been, the pickup -- the customer pick up on delivery has been much more tempered. So we are now in a handful of markets in the US. Expect through our partnership with Uber Eats to reach national coverage by the early part of 2020. But I would say that our expectations are that the business would grow over time. We know that convenience is an important need state for customers generally, and we've found that for Starbucks specifically that convenience is very highly valued. So we believe that over time a delivered beverage will be more commonplace, if you will, in the US and that we would see higher levels of acceptance. But I would say that it's building relatively slowly here in the US.

Q - Katherine Fogertey {BIO 15247533 <GO>}

And what you are seeing on the delivery side, would you say you're having more success on food delivery? Are consumers looking for food delivery over a beverage or it's just still very early days?

A - Pat Grismer {BIO 15965217 <GO>}

Well, for Starbucks it is a delivered beverage with the attachment of food. And what we are seeing in the US, one of the things we've observed across all of our markets where we've led with delivery is a higher ticket compared to an in-store purchase. And a contributing factor to that is a higher rate of food attach. And I think it makes sense. If you're ordering a beverage for delivery, you might as well have some food delivered along with it. I would say the other contributing factor and you see this particularly in office environments, is that the average party size is higher. And again, that makes sense. If someone in the office is ordering out for Starbucks, chances are colleagues will hop on to that same order.

Q - Katherine Fogertey {BIO 15247533 <GO>}

And are you seeing anything different with day part, with week, with the delivery business than you are within store?

A - Pat Grismer {BIO 15965217 <GO>}

It varies from market to market. So the very first market that we moved into with delivery, in fact, it was our pilot market with Uber Eats about a year ago was in Miami and we did see stronger sales in the afternoon day part in that particular market. We're seeing that in some other markets as well, which helps to complement with what has been, as you know, traditionally a very heavy breakfast or morning day part.

Q - Katherine Fogertey {BIO 15247533 <GO>}

It's really interesting. And touching back on what you're talking about with mobile order and pay and Alibaba in China. Is this helping to move the needle? Do you see this as an opportunity to help drive more of a morning day part in China, how our customers using mobile order and pay there?

A - Pat Grismer {BIO 15965217 <GO>}

We do see that over time it will be helpful to us in terms of how we can better distribute our sales across the day. What you've highlighted is that in China, as opposed to the US, we have a stronger afternoon day part. And so we do have more capacity in the morning. I do think that mobile order and pay helps to facilitate an established routine. So I think that has more Chinese consumers move into coffee and they understand the important role that coffee can play in one's morning routine. So, that will help to facilitate the growth of that day part?

Q - Katherine Fogertey {BIO 15247533 <GO>}

Yes, I very much understand the importance of coffee in the morning routine. And so, you referenced just a little bit with the rise of mobile order and pay in the US, but I think it's actually a very good point. We go into some of these stores, especially the stores in heavy transit areas in New York where, mobile order and pay is just swamping the stores, you walk in and their is just cups everywhere and a lot of crowd. And it's certainly a high class problem to have. But how are you guys thinking about the evolution of this business? And does it make sense to have a third space for mobile order and pay or should they exist in two separate locations?

A - Pat Grismer {BIO 15965217 <GO>}

So we are in the process of rolling out improvements to what we call the hand off plane, which is where you see those mobile orders accumulating in order to facilitate that part of the customer experience. You may have observed, particularly in stores in major metro areas like Manhattan, we are deploying additional labor in front of the counter to help direct traffic, if you will, to guide mobile order and pay customers to where those orders are accumulating and to hand off those orders to customers as they come in.

At the same time, we are looking over the next year to improve what we call order sequencing, so that we can better stage or sequence orders that are taken inside the store, as well as those that are coming in digitally in order to prepare the beverages in a sequence that better matches the arrival sequence of customers. So, a number of things we're looking to do to improve the experience for our partners, as well as for our customers, and with that, to unlock some of those capacity constraints so that we can accommodate more of the latent demand that time of day

Q - Katherine Fogertey {BIO 15247533 <GO>}

On that point on frequency, is it taking into account of customer's location where they have placed the mobile order and pay?

A - Pat Grismer {BIO 15965217 <GO>}

Exactly right.

Q - Katherine Fogertey {BIO 15247533 <GO>}

Okay. I can start opening it up to Q&A, I have more questions, but does anybody in the group have a question? Okay. On the labor front, labor wage inflation has been such a huge pressure to all the restaurant companies right now. And you definitely pay, I would say, above minimum wage to your partners and provide them with a lot of really good benefits. But you have also been doing a lot on the operations front to help streamline that process in the stores. So I was wondering if you could help us understand what are the things you're doing? How is this translating on the labor line and also to guest satisfaction?

A - Pat Grismer {BIO 15965217 <GO>}

So what we're looking to do is to reduce non-customer facing tasks through technology and improved processes, so that we can devote more partner time to the customer facing experience, if you will. So it's not about necessarily driving efficiencies that drop through to the bottom line, but allowing us to reallocate our hours in ways that help to sustain robust top-line growth. That would include what we're doing to re-engineer our cleaning processes, what we're doing to re-engineer our inventory management processes and also enhance our labor scheduling, both the speed and efficiency with which those schedules are set, but also to more intelligently allocate those hours and schedule those hours to the times of the day and to the tasks that are going to have the greatest impact on the partner-customer experience. So, for us, it's about finding those efficiencies that allow us to make the important investments in partner labor that are fundamental to Starbucks. We think that it's an important competitive advantage for us and it's something that we're going to continue to invest in.

Q - Katherine Fogertey {BIO 15247533 <GO>}

And how have the better customer scores, has that translated into sales growth for you guys?

A - Pat Grismer {BIO 15965217 <GO>}

We do see a strong correlation between our customer connection scores and comp sales by store. So we are very much of the belief that driving an improved customer experience, which starts with providing an extraordinary partner experience, is essential to our ability to drive comp sales on an ongoing basis here in the US in the range of 3% to 4%, which is part of our long term growth model.

Q - Katherine Fogertey {BIO 15247533 <GO>}

Okay. Yep. Back.

Q - Unidentified Participant

Just to piggyback off that question a little bit. On the wage and labor front, obviously, there's a lot of concern out there about the domestic recessionary pressures and the like that doesn't appear to be showing up in consumer focused data. But with respect to the labor and wage situation, are you feeling any pressure right now in terms of competition from competitors in the sense that they're luring away your employees at a higher wage? Do you feel pressure to pay more? Or are you seeing that seem to taper off a little bit, corroborating some of the worries that are out there?

A - Pat Grismer {BIO 15965217 <GO>}

The current situation is largely unchanged from what we've experienced in recent years, which is that, to the point Katie made, given what our pay practices have been historically, we have had a bit of a leg up on the competition. But beyond the wage rate is the compelling benefits package that we offer it, which is really, I think, unmatched in the retail space. And that's an important asset for us as it relates to our ability to attract and retain really strong retail talent.

Q - Unidentified Participant

Three part question. Can you first talk about food? You've made some acquisitions over the years, but I think your progress in food has been somewhat underwhelming. Second question is alcohol. You've made some initiatives in alcohol sales. I'm wondering what your thoughts are on that? And thirdly, Luckin Coffee and if you could comment on them?

A - Pat Grismer {BIO 15965217 <GO>}

Certainly. So starting with food. You are right to notice that as we talk about the key drivers of our growth going forward, food does not figure prominently in that strategy. And it's not to say that food is not important to our business. Current sales mix is, I think, around 21%. So it's a decent part of our business, but as I mentioned before, our growth at scale agenda has been to a significant extent rooted in focus and discipline. And when you think about a company of scale like Starbucks, given our stature as a brand and our scale globally, to sustain double digit EPS growth over the long term requires considerable focus and discipline.

One element of focus is being very clear about what our points of differentiation are and putting our effort, energy and resources behind those key points of differentiation. For us, in relation to product offerings, that's about beverages. So the innovation focus for us in terms of what's going to drive the top-line is around beverages. Food, I would say, is somewhat secondary in the sense that we see food as a complement to beverages, helps to build a ticket. It helps to build out additional day parts, but it is not necessarily a key point of differentiation for us. Our goal is to make sure that it is of consistently high quality, consistent with the Starbucks brand and that our food products pair well with our innovative beverage offerings. So that's food.

With respect to alcohol, I think, what you have seen have been isolated examples. We don't see alcohol as figuring prominently into our growth strategy going forward. There may be unique occasions or instances, for example, in our roasteries or maybe from time to time in some of our reserve stores, but it will not figure prominently in our growth strategy going forward.

And finally, in relation to Luckin, it's been interesting to see the growth and the evolution of that concept here in the last couple of years. I have to say that their unit growth is impressive. They I think for the first time as a publicly held company reported results in the month of August. And with those results, what we saw was that their unit count in China is about 25% lower than Starbucks at that point in time, and their average unit volumes about 75% lower or one-fourth Starbucks average unit volume. So you add those two things together, and even with all their growth, they're 80% smaller than Starbucks, one fifth the size of Starbucks in China. But they have grown very rapidly.

I think it's important to highlight that they're going after a different occasion. Their occasion is not a third place occasion. They don't have cafes designed the way ours are. That I think is reflected in their very low average unit volume and they satisfy again, a different occasion at a different price point, which also implies a different quality offering. So they are going after a different segment in the market. It's not to say that we should dismiss the presence that they've established, but also bear in mind that they have done that on the back of extreme marketing and very aggressive discounts. And I think it remains to be seen how they will be able to sustain that growth as over time they will be compelled to strip away their marketing and their aggressive discounts. So, we're continuing to watch to see what they do. I mentioned earlier that one of the three contributing factors to the tapering of comp growth in China for Starbucks has been competition generally. I would say not necessarily Luckin specifically, but they've been part of that mix.

Q - Katherine Fogertey {BIO 15247533 <GO>}

Yes. Okay. I mean, you referenced earlier, you guys pulled forward $2 billion of buyback into this year, it's more of a strategic decision. So, I'm just curious, you have so much dry powder on your balance sheet. You probably could raise more capital if you wanted to from the credit markets. Why was it a pull forward and why not accelerated share returns here? Or do you need to have more cash on the balance sheet for other items?

A - Pat Grismer {BIO 15965217 <GO>}

We don't need to have more cash on the balance sheet for other items as the Company undertook a review of its capital structure about a year ago. The decision was made to pivot to a more highly leveraged model, but still well below our peer companies in the category. So settling in at a still investment-grade credit at a leverage ratio on lease adjusted EBITDA of no more than 3 times and a credit rating of BBB+, Baa1 which I think for Starbucks is a terrific place to be in terms of how it improves our overall cost of capital, but still gives us the flexibility to make the kinds of investments that we believe are instrumental to our ability to sustain long term growth.

Q - Katherine Fogertey {BIO 15247533 <GO>}

And then on the CapEx front, you've had a pretty healthy CapEx budget as you're building up stores in the US and in China. And you referenced earlier the scale of US adds is slowing here. Is the current run rate a good run rate for CapEx? Is there something that would cause it to remain higher than unit growth over time? How should we think about CapEx?

A - Pat Grismer {BIO 15965217 <GO>}

Well, I would first clarify that when we say run rate, not speaking to, say, the last three to five years when CapEx increased very dramatically, but really looking at what our current spend rate is this year, I see the opportunity for that to temper when you take into account a couple of things. The first is that as we bring increasing focus to our to lead growth markets, the US and China, that implies that over time, we will be transitioning other Company-owned markets to the license model, as we did this past year with France, Netherlands and most recently, Thailand. And there are some other Company-owned positions that would make sense at the right time, under the right circumstances to transition to a license model. And so that will provide some relief to our total capital spend.

That, in addition to Siren Retail, which as our CEO, Kevin Johnson, highlighted a little over a year ago at the Oppenheimer conference, has been ring fenced with the opening of our Chicago roastery later this year, which we're very excited about, that will signal the end of roastery development. And there's been quite significant capital investment against our roastery portfolio in the last three years or so. And so as we bring that program to completion, then we would again expect a more tempered level of capital spend.

Q - Katherine Fogertey {BIO 15247533 <GO>}

Great. On the channel development side, you guys are adding more countries here. Can you help us understand how this business evolves and how the cost structure and revenue opportunity is as you add more countries?

A - Pat Grismer {BIO 15965217 <GO>}

So with the global coffee alliance with Nestle, we are excited about how that is going to further unlock the opportunity for us to drive the presence of the Starbucks brand in consumer products goods channels, not only traditional grocery retail, but also in food service. And to-date, we are in 16 countries and we expect that with the relationship with Nestle that we will be able to penetrate very rapidly the remaining, 60 to 65 markets where we have a retail presence.

One of the things we've observed is that, it makes sense to lead with specialty retail, to establish the brand. That creates awareness, that creates brand preference and then to follow with consumer packaged goods. And Nestle has the global infrastructure in consumer packaged goods to accomplish that at an accelerated pace, certainly much faster than we could have on our own, which was the underlying driver of that relationship that was established a little over a year ago.

How that relates to our revenue growth is that, we do earn a royalty on those sales and we also receive a markup on some of the finished products that we continue to manufacturer for Nestle to distribute. So there is an ongoing revenue stream in the form of royalties and product markups that follows the market expansion plan that I mentioned. With respect to the overall profitability, we continue to expect for our channel development segment operating margin in the mid-30% range. So, decent margins on that business.

Q - Katherine Fogertey {BIO 15247533 <GO>}

And then I have one last question for you. We have 30 seconds left. So one year in almost at Starbucks. What do you think is the greatest challenge here for Starbucks as we look ahead?

A - Pat Grismer {BIO 15965217 <GO>}

The greatest challenge for Starbucks is how to continue to reduce the operational complexity of our retail stores. When you think about the volumes that we process through our stores, transaction volumes, they're quite extraordinary, particularly at peak. And when you consider how we're continuing to introduce new beverage innovation, that adds another layer of operational complexity. As I mentioned before, however, what's fundamental to our success as a brand, what we see is our number one competitive advantage is the unique experience we provide in our stores and at the center of that, the connection that exists between our partners and our customers. So finding ways to continue to drive volume and drive innovation while reducing operational complexity that helps to unlock capacity and facilitates even deeper connections between our partners and our customers, that, I would say, is the key.

And a corollary to that from a financial perspective is how we pace and sequence the investments necessary to enable that reduction in operational complexity even as we innovate, because we believe that continuing to invest behind growth is important. It does weigh on our operating margin, but we believe that it's essential to our ability to drive top-line growth consistently over the long term. And as I mentioned before at the outset of the presentation, we continue to be very confident in the robustness of our double digit EPS growth model at scale.

Q - Katherine Fogertey {BIO 15247533 <GO>}

Well, thank you all for your time today.

A - Pat Grismer {BIO 15965217 <GO>}

Thank you very much.