

## Starbucks Corp 2018 China Investor Day

### Company Participants

- Alan Tong, Unknown
- Belinda Wong, CEO of Starbucks China
- David Hanson, Unknown
- Emily Chang, Unknown
- Jeff Miller, Unknown
- John Culver, Group President of International & Channels Development
- Kevin R. Johnson, CEO, President & Director
- Leo Tsoi, Unknown
- Thomas Shaw, Unknown
- Unidentified Speaker, Unknown
- Weiwei Chen, Unknown

### Other Participants

- Dennis Geiger, Director and Equity Research Analyst of Restaurants, UBS Investment Bank, Research Division
- Jeffrey Andrew Bernstein, Director & Senior Equity Research Analyst, Barclays Bank PLC, Research Division
- John Stephenson Glass, MD, Morgan Stanley, Research Division
- John William Ivankoe, Senior Restaurant Analyst, JP Morgan Chase & Co, Research Division
- Karen Holthouse, VP, Goldman Sachs Group Inc., Research Division
- Matthew James DiFrisco, Director and Senior Equity Analyst, Guggenheim Securities, LLC, Research Division
- Unidentified Participant, Analyst, Unknown

### Presentation

#### Thomas Shaw {BIO 17370352 <GO>}

Good morning, everyone. Welcome to Starbucks 2018 China Investor Day. I'm Tom Shaw, Vice President of Investor Relations and on behalf of our whole Starbucks team from Seattle to here in Shanghai we want to express how excited we are that you all -- you could join us today for our first ever international investor event. Before we dive into our presentation today I have just a few housekeeping items to cover. First, for those in attendance, we have provided a 1 page outline of today's events that will include all those important details you guys like to see like WiFi access and restroom locations. Second, let me give you a quick framework for the day and I'll pop up here a few times throughout to give you kind of updates as we move along.

So to start our day we'll have initial presentations that last roughly 90 minutes, we'll then have a short break before returning for our final speakers and then we'll wrap it up with Q&A. And finally for everyone in attendance and participants on the webcast, please take a moment to review our forward-looking statements that will apply to today's conversations.

So to kick off our day, we would like to share a quick video for everyone to highlight some of our history and early success here in China. Thank you.

(presentation)

### **Jeff Miller** {BIO 22161440 <GO>}

Good morning. Welcome to Shanghai. My name is Jeff Miller I am a 23 year Starbucks partner. I just returned to our China business a couple of weeks ago to look after retail operations in coffee engagement. I've spent -- I'm very proud to say that I've spent 9 of my 18 years in Asia as a part of the China team.

Right now you should each have a cup of coffee in your hands. Please enjoy the aroma and feel free to give it a taste as we share the story of this coffee with you. You probably already know a lot about what Starbucks China is known for. But today we want to share a story with you that you may not be quite as familiar with.

This is about a journey that starts about 1,700 miles to the southwest of here and ends with a cup of coffee that's in your hands. To kick off this special gathering, we want to take you to Pu'er, in the rolling foothills of Yunnan province and share with you the efforts of our partners there to improve the quality of Arabia coffee. In only 6 short years Alan Tong and his team have succeeded where no one else has.

Where less than a decade ago, Yunnan coffee was primarily used in mass coffee products around Asia, Yunnan Arabicas can now be found increasingly in specialty coffeeshouses around the world, including most recently as a reserve feature at our Shanghai and our Seattle roasteries.

This is largely because of the work of our Farmer Support Center and our dry mill operations. And this is only the beginning. But as important as the coffee is itself, is the source of pride that Yunnan coffee has provided for our partners and our customers and we're very excited to share this with the world.

So this morning it is a joy to share this with all of you and it is my privilege to introduce Alan Tong, our director of the Farmer Support Center and dry mill operations in Yunnan.

### **Alan Tong**

Good morning, everyone. The coffee in your hand is from Yunnan. Can't you taste the good sweetness and the citric acidity? It is very, very balanced with some green

tea like note. I roast it for you and brought it to you from Pu'er, where we have 1,700 farms with 17,000 hectares verified through our C.A.F. E. Practice.

In 2012, we started our coffee journey by establishing the Farmer Support Center and the dry mill. We have 4 agronomists in the FSC and 33 operation staff in the dry mill. They both have very perfect collaboration, like a yin and yang in Tai chi. The FSC gives the trainings and support. And the dry mill gives the premiums for the good quality.

Over the last few years, my team and I, we spend most of the times in the vehicles driving from one farm to another, getting to know the farmers, helping them building the trust in order to get to where we are today. Now, it makes us the buyer of choice to your local farmers with an annual purchase increment by 7 or 8x than the year of 2013, when it was only 1,000 metric tons only. And never forget that no one knew about Starbucks at the beginning. I was confused. Really? Huh. Am I going to Michael J. Fox in The Back to the Future 4.

The first time training that we had with the farmers, it was only 25 people. And I had to treat them with very delicious dinner after that. Even today, I am not so sure. What made them come for the training? My charm? Or that dinner?

And last November, more than 4,000 farmers drove for hours to the farmer assembly. And taste their fruit of their labor and celebrate their dedications to improve the quality for Yunnan coffee. Being a leader in my dictionary has 2 important keywords. That is "leverage" and "change." Because the years of hand in hand hard work with the farmers, we are already part of the extended family. And the leverage is constant. We could see many positive changes; not only to their livelihood, to their farming practices, to their quality awareness. But also to the recognition by the world for Yunnan coffee.

Starbucks is going to elevate Yunnan coffee industry. And that is for sure. The first 10 feet is not a long distance, however, it takes us six years to get it here. Please, let's take another sip of this coffee, especially for this occasion for you. Today, we are so proud of that we have our own roastery in China, where we could have our best Yunnan beans to be roasted and delivered to our stores for the customers to enjoy.

Let me introduce my partner from the Shanghai Roastery, (Hoho).

## Unidentified Speaker

Thank you, Alan. Good morning, all. My name is Hoho I'm a established coffee roaster at Shanghai Roastery. It's a such big honor to share our Yunnan coffee here. I still remember the first time when we roasted Yunnan coffee at Shanghai Roastery, the 8 of us the first bench of China roasters had just finished our training and they are attentive Shanghai from Seattle. We were very excited, yet nervous about roasting this coffee. That's so close and dear to our hearts. We discussed about roasting plan again. And again with our master roasters. Trust me, you will be amazed if I share all our ideas and the plans we went through.

When the first Yunnan coffee bean came out from the roasting machine, we cheered. We hugged each other. We cried. What an incredible moment. Chinese coffee roasting in China by Chinese roasters. Can you imagine how proud we were? You probably can tell how proud I am right now.

So if Alan's team gave Yunnan coffee life, I wish we roasters can give Yunnan coffee a great stage, it's just like Starbucks always does to us partners, we're not just roasting coffee, we help coffee to show itself, to partners, to customers, to you and to the world. We let coffee speaks for itself. Please enjoy this unique balance of this Yunnan coffee. I will now pass it on to George, who present our Chinese barista and to tell you what Yunnan coffee means to them. Thank you.

Thanks Hoho. Hi, everyone, I'm George and I am from Kunming, the capital city of Yunnan. I started on my Starbucks journey in September 2012 as a part-time barista, when I was a junior in (college) and now I am a store manager of the first Reserve store in Yunnan. And I'm very proud to share the Starbucks model of Reserve coffee to all our customers in such a unique location.

My partners and I enjoy using different brewing methods to present the best coffee to our customers. I remember the first time when my partners and I tasted the Yunnan reserve coffee beans, we were stunned by its unique herbal flavor. I want to know more about the Yunnan coffee beans I can share with my partners and customers.

Later on I had a chance to visit the Farmer Support Center in Pu'er and all my questions for Yunnan coffee beans were answered. I got to know every single staff involved. But the big takeaway for me was, I realized every Yunnan coffee bean is a result of the hard work of Yunnan coffee farmers and our partners, from the Farmer Support Center.

After I went back to my store, I hosted a special coffee tasting to share my experiences on the (inaudible) coffee with my customers. That day we sold out on all the Yunnan coffee beans in my store. My partners and are honored to use our skills to present the Yunnan coffee to our customers in the last 10 feet.

**Jeff Miller** {BIO 22161440 <GO>}

Thank you very much, George. This is the China seed to cup story that makes our partners and our customers so very proud. And what you've just heard is a true testimony to the passion and the dedication that our partners have for everything that we do around coffee here in China. So thank you very, very much for sharing in the special coffee with us this morning. Thank you.

And it is now my great honor to introduce our CEO, Mr. Kevin Johnson and welcome him to the stage.

**Kevin R. Johnson** {BIO 3773960 <GO>}

Give him a round of applause. What a wonderful coffee tasting. Thank you. So much. Well. Good morning, everyone. Welcome to China. It is an honor to host all of you here for this 2-day event. I mean, this is the first time we've had the opportunity to host a China investor conference. And I must say, I have visited China many times, numerous trips here. And it really is a second home to Starbucks.

But I must say, it's very difficult to describe the experience that you have here in China. You must experience it in person. And so, I want to begin by thanking each of you for traveling and investing the time and the resource to be with us over the next two days.

Now, Belinda Wong and her team have prepared a wonderful journey for you. This journey will, I guarantee, will make it worth your time. And to really understand Starbucks China, you must experience it. And over the next two days, you will have an immersive experience on all aspects of China.

Jeff and the team shared a little about the work we're doing in Yunnan, around origin. You're going to have an opportunity to immerse with store designers, with our product R&D, with our digital ventures, with our partners resources team and our channels team. Every aspect of how Belinda and her team bring the Starbucks experience to life here in China.

Now, let me set a little context before we begin. This represents a long-term growth opportunity for Starbucks. And we've been in China for 20 years now. And we have built this business in China, for China. In fact, it is clearly one of the top priorities and it requires focus, it requires discipline. And it requires us continuing to take the long-term view.

Now, this past year we have worked at the enterprise level to really amplify our focus on the core value drivers for you, our shareholders. And let me summarize 3 things that I believe are supporting our agenda here in China.

I want to take an opportunity to share a little perspective on streamline and how the streamline efforts are helping us really amplify the core value drivers, especially here in China and the U.S.

I want to share some thoughts on the global coffee alliance that we announced last week. And specifically how that global coffee alliance can also support our agenda here in China. Then, third, I want to just share a little about how this amplified focus on value creation combined with the management philosophy that we use to really empower Belinda and the team you're going to spend the next two days with to run this business in China.

There is more innovation coming out of Starbucks China than any other market in the world. And that is much about the leadership team, the way they're empowered. And we're going to take you through that over the next two days.

Now, let me just start by sharing a little bit about streamline. Over the last year, we have communicated consistently with you about our activities to streamline the company so that we can focus more of our energy, more of our capital, more resources on the core value drivers going forward.

Now, I think about streamline around 3 main pillars. Retail alignment, business simplification. And this Global Coffee Alliance.

Now, specifically retail market alignment really is representative of the fact that we have been aggressively licensing retail markets that have either lower returns on invested capital or lower upside in terms of new unit growth.

Examples have included markets like Germany, Singapore, Taiwan and Brazil. We've transitioned in those markets over 800 stores from company-operated to licensed stores. And in addition to transitioning some of these markets to licensed we have also deployed capital to acquire 100% of the joint venture in East China.

That is enabling us to now unify all of mainland China around a company-operated model and create some synergies that Belinda and team will take you through later this morning.

Now, the second pillar business simplification is really about either divesting of non-core slow growth assets and simplifying our internal business operation. We sold Tazo Tea to Unilever so that we could focus on our core premium tea brand Teavana. We also closed the Teavana specialty retail stores in the U.S. and North America realizing that the place we were selling over \$1.6 billion of Teavana was in Starbucks stores. And as we took Teavana globally in Starbucks, that was just fueling additional growth.

We also optimized items for sale in our stores in the U.S. through a SKU rationalization process. And that resulted in roughly the reduction of about 30% of the SKUs that we sell in the lobby and some efficiencies that we have on the food and beverage side. The business simplification is allowing us to get more efficiency and put more of our energy behind core value drivers.

Now, the third pillar is something we announced just last week, which is a global coffee alliance with Nestle. Now this is an opportunity to significantly accelerate our international CPG and food services business. Now, I think about this in many ways. When we open Starbucks stores in a market, we establish the brand. And that brand is established by the fact that customers come visit our stores. And the experience we create for them in the stores sets the tone for the Starbucks brand.

Now, we have demonstrated in the U.S. and Canada that when we complement the work we do in our stores by selling Starbucks products at grocery, mass merchants and food services it becomes a brand amplifier. So the customers that understand the brand from their experience in Starbucks have an opportunity to purchase and sample a wide range of different Starbucks products at grocery, mass merchant, food

services that strengthens their affinity for the brand and brings them back into our stores.

There is a synergistic approach between CPG food services and our Starbucks retail business. Now we have proven that in North America, where that business has just been on fire for the last seven years as we have growth that and as we have built that business. But candidly, we are in 76 countries around the world and having a CPG food service success in the U.S. and Canada means there are 74 other markets where we have established the brand but either the CPG and food services businesses is nascent or nonexistent.

So this global license agreement with Nestle allows us to continue to control our brand and at the same time Nestle will leverage their massive scale and capabilities for global distribution. This licensing partnership includes an upfront payment of \$7.15 billion to Starbucks, as well as ongoing royalty and product fees to provide meaningful economic incentives for both companies, we are incented to continue to grow this both strategically and economically.

Now that growth will come in a couple ways, one, our expansion globally into new international markets, Nestle brings over 5 million points of presence in 189 countries. Now certainly, a subset of those points of presence are going to be places that are very applicable for Starbucks products to be sold. And so our opportunity to go market by market and build a thoughtful plan about how we are going to enter that market with the right products, the right points of presence and we will prioritize that following the close, we will work with Nestle on the next wave of plans we have to expand that. But that is growth, growth opportunity.

The second aspect of growth is the fact that Nestle is opening up an espresso and Dolce Gusto systems platforms for the first time to Starbucks coffee. Now, let me just remind you that Starbucks sold our first K-Cup on the Keurig platform seven years ago, we became the #1 premium brand on K-Cups in the United States on the Keurig platform within four years of getting on that platform. And we have continued to grow share every year since then.

Now today the Keurig platform is focused specifically on North America and we are going to stay on the Keurig platform but the fact that an espresso and Dolce Gusto platforms are global means that the installed base of systems that they have on a global basis far exceeds that of Keurig. And so our opportunity to grow not only by geography but by new products on the espresso and Dolce Gusto platforms opens up a huge opportunity.

Now the third aspect of this global coffee alliance is around sustainability, we share a commitment to make coffee the first sustainable agricultural product. And this means that we have an opportunity to embrace C.A.F. E. Practices that ensure that farmers get paid equitably for the coffee they grow, we have the opportunity to collaborate on the agronomy research that both companies do. And to leverage our Farmer Support Centers in an open source model to share what we learn to help

coffee farmers around the world improve their yields, embrace hybrid coffee trees that are rust resistant and help ensure that we continue to facilitate and embrace coffee farmers to grow the world's finest coffee.

Now all of these streamline actions have netted in aggregate approximately freed up about \$8 billion of capital, approximately \$8 billion of capital freed up through the streamline actions that we have announced. Now, we redeployed \$1.3 billion of that capital into East China and you will hear more about that today but the net of all streamline activities that we have done are accretive to both revenue and EPS in fiscal '18 and '19 and they have enabled us to increase our cash return to shareholders to \$20 billion over the three years fiscal '18 to '20.

Now, all of that is allowing us to focus much more on China. Now, from the moment we opened our first store in China, in January 1999, we have been playing the long game, we built and maintained a company that has a deep respect for the Chinese culture, our customers. And the partners who proudly wear the green apron in more than 100 cities throughout China.

No western company or brand is better positioned to benefit from the rapidly expanding Chinese middleclass and certainly we continue to be mindful of the fact that we will evolve a coffee culture in China, where the reward will be healthy, long-term profitable growth for decades to come.

The extraordinary Shanghai Roastery, which we will host you out this evening is building on our long history in China and it continues to exceed all expectations. Now, the financial returns from the full acquisition of our East China business are already running ahead of our internal guidance and it will contribute 2 points of EPS growth this year. And that profitability and that momentum should accelerate as we move into fiscal '19 and beyond.

Now, the leadership team you are going to see here today is fully integrating and optimizing this for the future, in fact Starbucks manages, we invest in. And we grow our brand with a global focus. We are playing the long game. And Belinda and her team have done a phenomenal job and brought the Starbucks brand to life here in China in a local way.

And that gets to the management philosophy, many times I have to decide what are those things that we do globally. And what are those things we do locally. Certainly, our mission, our core values and our brand are things that we embrace globally but when it comes to everything else in China, it is done locally. Belinda and her team are fully empowered to respond, to react, to adapt the Starbucks brand here in China, which is why over the next two days you will see that we have integrated the entire set of leadership functions needed to run China in a way so that China is built here in China for China; the store development team, the product R&D team, supply chain, digital ventures, partner resources, channel development all contained within the China leadership team that you will meet here in the next two days.



And I will tell you the pace of innovation that is taking place in China especially in Starbucks China is exceeding any other market in the world. We learn so much from the work they do, whether it is work they have done around store design and the fact that we have over 140 Starbucks reserve bars here in China, they invented the concept. And it is a concept we are now taking globally. You look at the work they have done on digital, they embrace social gifting. And you look at the fact that over 60% of their tender is now paid for through the mobile app. Innovation, product R&D, we are going to take you through our R&D lab later this morning or later this afternoon and you will have an opportunity to sample some new beverages and get a sense of the work that is going on here from an innovation standpoint.

So this next two days is all about Belinda and her team, it's their show and they are empowered and I am just here to serve them. So it is my pleasure to introduce you to the CEO of Starbucks China, my friend and great partner, Belinda Wong, Belinda.

### **Belinda Wong** {BIO 17337899 <GO>}

Thank you. Hello. Thank you, Kevin. Good morning, welcome to China. Finally. Welcome to our Shanghai support center and welcome to our home so. So happy to see you all here. Very excited to be able to share with you in person our ambitions and in Starbucks fastest growing and most strategic international market.

The extraordinary business performance that Kevin mentioned just now in this market did not happen by chance, it is the result of the love, pride and dedication of our 45,000 Chinese partners. Each critical pillar of our business is led by some of the most talented and dynamic leaders in the market on my leadership team.

And you have already heard from Jeff, Jeff where are you, Jeff about our passion and pride for all things coffee. And how we want to help bring, help bring the best of China's coffee to the world stage.

It is my privilege to formally introduce you to the other members of my awesome leadership team, the China leadership team. Stand up. You've been working really hard. Leo Tsoi, our Chief Operating Officer, you guys can come up here, they can't really see you. He's also leading Store Development and Supply Chain, for China. Emily Chang, our CMO. Weiwei, our CFO, I'm sure you love to talk to her and you have the chance. Laura, heading Partner Resources. Laura, wave. Victor Cui, the guru heading our Public Affairs, everything government relations. Linda Zhang, R&D, heading our R&D, quality assurance, regulatory. Mr. James Li, our China technology guy. Buay Beng Tan, this is the person you want to talk to, because she's heading our East China integration and East China business. Jason, where are you? He's keeping us legal in this country, heading our legal functions. Jane Lau, heading our food business. Molly, she has the best job in the country, heading Digital Ventures. Grace, she's the person who created the Shanghai Roastery and heading the Siren Retail. And Mr. David Hanson, soon become a Chinese, heading our Channel Development Business. Thank you. Thank you, all.

So over the next two days you'll be able to interact with them in person and I know each one of them is dying to share with you their own Starbucks story and their excitement about the opportunities ahead.

Almost 20 years ago, Starbucks pioneered the specialty coffee market in China. We introduced a unique third-place experience in serving high quality coffee to our Chinese customers. Fast forward to today, no other coffee retailer in China has the depth of our coffee expertise or the breadth of our store footprint, partner experience, product innovation. And positive impact in the community.

The Starbucks experience and the personal moments of connections our partners have with our customers 6.4 million times every week simply cannot be replicated. So how did we do this? You heard from Kevin before that Starbucks has cracked the code in China. I would love to humbly, humbly share with you our experiences and learnings.

As you sit here this morning, there are 3,300 stores across 141 cities in mainland China. We're not just opening a new store every 15 hours. But a new store that is profitable and with great returns. This did not happen overnight and it is a result of our disciplined growth. We tested our ability to accelerate our growth with no compromise on our values and commitment to deliver the unparalleled partner and customer experience.

Today, we have the world-class capabilities to open hundreds of new stores every year. China is a very, very dynamic market. It requires us to learn from each new store opening and innovate to build the next one better. And one of the most strategic investments to enable our accelerated growth is our own China design studio, with 120 very, very talented designers we've delivered the newest class of enticing and welcoming stores that is outperforming and delivering record transactions and profits far, far above any of our peers had.

We've also established Starbucks as tenant of choice. We have developed many strategic partnerships with premium landlords. This is giving us unprecedented access to some of the most sought after retail locations all across China with the most preferential terms. Our stores are located in some of the most high traffic, prime lifestyle locations, in malls, transport hubs. And the finest commercial centers. This too, cannot be easily replicated.

China was a tea drinking country when we entered the market back in 1999. And it still is. We had to learn how we can introduce a specialty coffee culture lifestyle to our customers. We listen intently to the needs of our customers to translate the unique Starbucks experience in a locally relevant way. We have to stay agile and have the capability to innovate.

This commitment to innovation led us to open the first Starbucks R&D center in Asia, right here in Shanghai. This is another strategic investment we made to unlock our dayparts with the right food and beverage offerings. 85% of our beverage offerings

are created in China, for China. And we're developing 100% of our local food offerings.

While I see a great potential in our morning business, I love the fact that our dayparts are so balanced. We've an equally strong lunch, afternoon and evening business. Our passion and our focus is to continue to enrich each and every daypart and lift the entire base of transactions throughout the day.

We take the authentic relationships we have built with our partners, customers, strategic suppliers and other key stakeholders like government and media very, very personally. We have to continue to earn our trust and credibility every day. Success is certainly not an entitlement. We need to earn and preserve those trusted relationships and friendships. That is what makes Starbucks so well integrated in the fabric of the Chinese society.

The Shanghai Roastery, where we dreamed up and landed a never before seen innovative experience, is one of the best reflections of the incredible relationships we have built with the local government. Starbucks and our Shanghai Roastery have been quoted on numerous occasions by the government as the role model to support the country's innovation agenda.

I think we've done a pretty good job so far in translating the Starbucks experience locally. And you'll hear more from each of our speakers later.

Right from the beginning we wanted to be a different kind of company. We want to be a purpose-driven company in China. Taking real actions and responsibilities to role model what a for-profit company can do for its people, society and for my country. What makes me most excited about our new store openings is our ability to promote a new store manager every 15 hours, a new district manager every week. And an area director every quarter. We're doing our part to train the finest retail leaders for the future. The best people leaders with great business values and ethics for my country.

And we're also creating over 10,000 new jobs every year. The better we do, the more we can invest back to our people and communities. We, our 45,000 partners, all share the same purpose, pride and beliefs. The purpose-driven culture is what fuse our passion and energy to do what we do every day. We want to achieve something bigger than ourselves, unique to Starbucks in China is the culture, a family, a value that is deeply rooted in the Chinese tradition.

As we continue to accelerate our growth, we recognize our increasing responsibility to leverage our scale, to innovate around the partner experience and also to take great care of their families. Success is best when shared. And we've launched many unique partner benefits in China already. We went beyond what most companies would offer to their people here.

We have the same comprehensive life, accidental and medical insurance benefits to the spouses and children of our fulltime partners. We also pioneered first of its kind critical illness insurance program for the parents of our partners. In my opinion, there's truly no other retailer like Starbucks in China. Everything that we've done has been laying the foundation for a much, much bigger dream. We are so excited about the enormous opportunities ahead. I have spoken extensively in the past about the significant growth opportunities and the synergies or efficiencies we'll gain through the integration of our East China business and additionally with a rapid pace of the economic growth development taking place across China and the rising middleclass with much higher disposable income will undoubtedly drive the coffee consumption growth here in this market.

All this will boost the demand for Starbucks. We're so confident for our long-term growth and development in the market, with that I am proud, very proud to share with you our purpose-driven China growth agenda. Centered around our partners, their families and communities we will be laser focused on strengthening local relevant innovations, experience and moments of connections with our third place strategy. Build even deeper relationships with our customers in the fourth place with our digital flywheel and extending our brand reach by weaving the Starbucks experience into the fabric of the Chinese millennial lifestyles through Starbucks on the go.

These 3 pillars together with our aspirations to give back to the Chinese communities are our purpose-driven China growth agenda. And we will be obsessed in delivering with results and pride in the coming years.

The third place strategy is a holistic, multi-sensory approach from the location, store design, food and beverages, partners and customers connections, all the way to how our baristas passionately show-off their craftsmanship and knowledge on coffee.

This is the theatre for the ultimate Starbucks experience and we excel in this area by far. And that is why our brand resonates so well with our modern Chinese customers, it's also the reason why the brand triggers so many Instagram or WeChat moments.

But the needs are forever evolving and we need to continue to push the envelope to exceed the expectations of our customers. Leo will share in details what we have been doing and the focus of our efforts going forward to fuel our growth in that area.

While it is important to win in our third place, it is equally important to win in the fourth place the digital space. Chinese consumers now are among the most digitally savvy costumers in the world. The third and fourth place need to complement each other and redefine a new retail experience. And Emily will share our plans to make the fourth place an integral part of the complete Starbucks experience.

Then I'll have David Hanson to wow you with the runway for growth ahead to build our distinctive made in China, for China on the go business portfolio. Last but not

least you have-- you'd love to hear from Weiwei, our CFO, who will share with you our disciplined growth approach and the financial health of our business here.

In closing, it has been an absolute privilege to lead this unprecedented era of growth and be able to work with our fine partners here, who care so deeply for our brand and for each other. My optimism for the China market has never been greater. Our collective hard work and investments made in the past 20 years has set the perfect foundations for us for our future.

With that I am thrilled to announce that we will be accelerating on our store growth, Starbucks China will set a new goal to double our store count to 6,000 stores in over 230 cities across the mainland by 2022. That means we are going 20% faster, growing 600 net new stores annually starting this fiscal year and entering into an additional 100 new cities. We are still in a very early stage beginning chapters of our purpose-driven growth story here in China.

We will continue to create history with Starbucks coffee company and I promise you we will one day be larger than the U.S. market, thank you.

Now, It's my pleasure to introduce to you one of the heroes behind the early success in Starbucks China, my great friend and our Chief Operating Officer, Mr. Leo Tsoi.

**Leo Tsoi** {BIO 19965066 <GO>}

Thank you very much, thank you Belinda. Good morning, everyone I am Leo Tsoi, the Chief Operating Officer of Starbucks China. Welcome to Shanghai again. I am delighted to share with you our strategic growth initiative to elevate our third place strategy.

I joined Starbucks China in 2012. I was born in China and educated in Hong Kong. I love our country. And I am incredibly proud to come to China to serve the Chinese people with my understanding of China and (my brand) and commercial experiences from P&G, Starbucks Asia Pacific and PepsiCo.

After 15 years in China I continue to be proud and inspired by how our country is developing on a daily basis. In fact this uniqueness requires us to build the Starbucks brand in a dynamically different way. And let me share with you some of the insights that we have been seeing over the years. China's middleclass population is expected to double to 600 million by 2022. Today, 450 million millennial in China aged between 18 to 38; while the middleclass is known to be strivers, the Chinese millennial are known amongst the most well educated and well-traveled.

They seek innovative experiences to fulfill their aspirational and global lifestyle but they also have a strong pride and respect for the Chinese culture and heritage. And this is why our holistic made in China for China third place experience has a strong appeal to them. Also you must remember 1 important fact the nearly 150 million of the population, half of the size of the U.S. population who was born under the

China's one child policy between 1980 to 2015, this generation, they crave human connections either with their friends or to spend quality time with their friends and families.

The sense of community that our partners have created in our third place will be more relevant and important in the years to come. This aspirational consumer lifestyle needs will continue to be the driver of our creation of future innovations. And there are 3 key growth drivers, they are important to elevate the purpose driven China growth agenda.

#1 is to drive the penetration in breadth and depth to meet the increasing and evolving (mid stage) and importantly to acquire new consumers. Second, it is to double down on our innovations to inspire new occasions and increase frequency. And last but not the least, it is to elevate the Starbucks experience through premiumization.

Now, let me explain how we are going to interpret these drivers into our third place strategy. With 1 stall opening every 15 hours, Starbucks China has tripled our store count to almost 3,300 in the past four years. This rapid star portfolio growth far exceeds our peers had and is on par with our U.S. market in the early days of the trajectory growth.

We have learned and continue to fine tune our skills and ability to balance the existing store sales with new store growth. And you are seeing almost all the stores across China have achieved profitability and solid financial performances and profit growth.

And this is the result of a successful network goal strategy with a discipline to go wide in the new cities and our intentionality to innovate in the city when we go deep. Our going wide strategy requires a holistic approach across the functions. And carefully consider and analyze in each and every city that we enter.

Behind me are the photos of the first opening in a city like Qian'an in Hebei. Look at the enthusiasm of our partners and the long lines of the customers waiting to enter our stall, when we first open. This amazing and excitement scene has actually happened over 70x in the past five years when we enter the new cities. If fact, did you know that all of them have achieved their profitability starting from the first year?

As Belinda just announced, we will bring this same experience and approach to another 100 new cities by 2022. And let me remind with another important fact. The majority of these new cities are home of an average of 4 million people, approximately equivalent to the size of Los Angeles.

Everyone, what this means is that we are going to be introducing the Starbucks experience to a population nearly 100x of Los Angeles in the next five years. Now, how can I not be excited about this amazing runway of growth ahead of us?

Now, let me also share with you our strategy to deepen our existing stores when we enter into -- when we have entered the cities. We grow with our customers with our Starbucks discovery journey. We intentionally elevate our store profile and portfolio as we scale in each city.

Importantly, we also introduce new concept and new format, in the city where we open our store, to enhance our reach and deepen our connection with our customers. Our customer's first engagement with Starbucks is typically through our beautiful core store.

Now, as they grow, we begin to strategically to rate relevant experience, to exceed their evolving needs. One example, it's the Brew Bar they were pioneered back in 2013. Now, Brew Bar it's an engaging handcraft platform, that we use Siphon, Chemex, Pour Over, to brew to handcraft our beautiful cold coffee, such as Kenya and Sumatra.

We deliberately make our Brew Bar low, close and neat, because this is the stage where we handcraft taste, share the passion, share the love and the quick taste of our beautiful coffee with our customer, one-on-one.

And over the years we refined our Brew Bars by up-leveling the brewing technique. But we also push ourselves hard to keep it simplicity, because we know the key is to enable this connection between our partners and our customers when they are in the Brew Bar.

Now, I'm so proud to share with you, we have introduced Brew Bar in more than 1,000 stores in China. This high level engagement Brew Bar actually inspire us to evolve this experience when we introduced the Starbucks Reserve brand in 2014.

Now, when a city and our customers are ready, we will introduce the Starbucks Reserve Bar to invite our customers to lean further to a even more premium experience. Our Brew Bar brings to life a even higher level of coffee craftsmanship and importantly showcase, we can go beyond the product experiences by delivering an elevated multisensory experience when people are in the store.

And only the certified Red Apron coffee masters can operate our Brew Bar and brew and handcraft our premium Reserve coffees. And today, we showcase our Reserve coffees in over 150 Starbucks stores in the Reserve Bars in China. And we expect to reach 200 stores of our Reserve Bars by the end of fiscal year '18.

But that's not all. We need to constantly evolve ourselves with our customers, as we continue to expand in a city. For example, the Chinese customers are probably some of the most mobile consumers in the world. China has the world's largest railway network, 4x bigger than Japan.

So we are building more stores in transport hubs across our cities to serve the 1.5 billion passengers passing through these 5,500 hubs every year. Additionally, we are also introducing new core stores with different format and profile, to elevate the Starbucks experience with the rising middle class.

Our residential store format, it's actually a neighborhood store build with and designed with the comfort of a living room and a (sail through) bar where our partners and our customers hand you coffee side by side. You're looking at a store that we opened last year in a community in Changzhou, Jiangsu with 20,000 residents.

And similarly, our new pet friendly store, we invite our customers to come up for a coffee with their pet-friends. So each and every of this format are actually decide intentionally to create more occasions to build a daily coffee ritual.

Then there's our flagship portfolio. Our flagship is -- the statement to our brand in China. It's a complete multisensory, theatrical experience at the next level. Since our first flagship opened in Beijing Kerry Center in 2013 we now have 6 flagship stores built and opened across China.

Successful programs such as our bar element, product offerings, are all replicated across the regions. We learn from each other to make the next one better. And even with more inspiring and innovative experiences.

And today, I'm so excited to share with you our latest flagship evolution, the Beijing (One) store, opening soon in June in Beijing. This the largest store aside from the roasteries. It is the store 1 km away from Tiananmen Square. With this 10,000 square feet space, we are featuring 3 distinct platforms the Reserve bar on the ground floor. And then a Teavana bar and then mixology bar on the top floor. This first of its kind immersive star experience outside the roasteries of Shanghai. It's actually a tribute of our relationship with the Beijing community, where we started in China nearly 20 years ago.

Now, the growth story in Beijing is not a one off. In fact, it only highlights our intentionality to create the regional and city center to bring this Starbucks experience alive, region after region, from the east to the west and city after city, from Beijing to Shanghai. And from Guangzhou to Chendu.

Now everyone, what I just took you through is a firm demonstrations how Starbucks China has been able to create, to test, to launch and importantly to land the next generation of innovations and creations to fit our ever-changing lifestyles and the consumer needs here in China. This is an important capability that we must have to win in this market.

Now, the third place strategy is not just about our store and the beautiful space. It is also about our product experience. Our customers discovery journey actually continues across our 3 key beverage platforms, the core, the coffee forward. And the



seasonal offerings. The Caffè Latte, the Cappuccino and Frappuccino. And other Starbucks core classics are all delivering significant sales in our portfolio.

You have to remember, this product in a new city like (Tiemenguan) they define the first taste of our customers with Starbucks and they form the foundation to pure daily coffee ritual for the many years to come among this group of customers. Now, in the past few years, we also tailor make our (menu brought) to facilitate easier and faster decisions, when people are in front of our bar.

Over time, of course, some of the customers, they will gradually shift to our coffee forward offerings, when they seek to know more about coffee. Did you know that we have already rolled out our (inaudible) in all our 3,300 stores in China? Now, within the past 18 months we also introduced Nitro Cold Brew in nearly 400 stores. Also, in the past nine months we have introduced our Avocado platform in 260 stores in the market.

We are so excited to see this coffee forward platform, leading our growth with 59% CAGR over the past four years. Now, of course, here in China we have to talk about tea, right? Everyone, you are in a tea nation, where tea is significantly larger than coffee. We have introduced Teavana with a creative interpretation of the Chinese tea culture an element in 2016.

Our re-imagined tea innovations, posed an exceptional 45% -- sorry 40% CAGR growth in the past four years. I really cannot wait to have you visit our Teavana bar later tonight. You will be excited to see, it has far exceeded our expectation. And the reason is simple. Because we're creating an familiar, yet unexpected experiences on tea, when people are in front of the bar, it is unique and very premium.

Our seasonal beverage offerings are also helping us to create new occasions in our stores, as our customers love all kinds of celebration, holiday and festivals. Our China R&D and marketing team have created relevant beverages for the modern celebrations. For example the Singles Day on November 11, I think you all know. And you probably also know the upcoming May 20, the China's Days of Love, because in Chinese, it's reads, "wo ai ni" "I love you" and all these innovations and products are created to really attract and delight our millennial customers.

This again demonstrates our ability to remain agile and (inaudible) and importantly to respond swiftly to the emerging consumer needs. And we have taken a complementary approach with our food innovations to elevate our core daypart and develop the new consumer behavior.

For our strongest afternoon daypart, we are constantly evolving and innovating on our iconic cake series as a coffee treat for the aspirational middleclass. And of course, we are also innovating to fill our morning and lunch daypart with unique food offerings for every occasion.

The food options, like our proven U.S. breakfast sandwich and bakery line, as well as the newly introduced Greek yogurt series are the re-fashioned of the latest consumer taste preferences. And for holidays, the mid-Autumn festival in September. And Dragon Ball festival in May, we also create modern interpretations of this 1,000 years festivals and occasions. And also give solutions to the middleclass and the millennial. For example, our Moon Cake retail up for almost USD 100 a box. It's highly sought after a premium and exclusive gift, when people are looking for something to express to their loved ones. And this is why our Moon Cake has exceeded 30% CAGR growth in the past two years.

Now, everything that we do from the store design to our innovative food and beverage offerings to the gift occasions and options has holistically elevated the Starbucks experience. They build on each other to truly deliver a premium experiences within the third place. And this is the reason why the third place remains the most preferred gathering point and has resonated so well with the modern Chinese customers.

That said the beautiful store and innovative product are only part of the story. Our partner's passion to perfect the coffee crop is the real key for the success of our brand. The craftsmanship is actually embedded in the 1,000-years history of China, as you all know. This comes to life in our store, when pairs of customers serve as (servu) the Chinese mentor and through the apprentice, just like in the movie Kung Fu Panda.

So by joining this traditional bond and together in the store, a culture of family is formed in each and every store we operate. It's culture, it's amplified by the retail and coffee education program available through our Starbucks China University.

As our partner gain deeper understanding of the bean to cup journey, they graduate to the next stages, from our core store to Brew Bar, to Reserve Bar and to flagship and finally to the highest level of our coffee craft, the Shanghai Roastery.

Now, in closing, I am so excited with our third place strategy under the (purpose chief) on China growth agenda. We are the undisputed leader to bring the Starbucks third place experiences alive. In a way that was steeped in a deep respect of our culture here in China and also responsive for the ever-changing needs. I know this is only the beginning and I cannot describe to you the enormous opportunity ahead of us when coffee becomes a daily ritual here in this market. Thank you, everyone.

And with this, I will hand you to Emily, our CMO, one of the smartest persons I have worked with. She is going to tell you how we're going to merge digital in third place and redefine new retail.

**Emily Chang** {BIO 17006844 <GO>}

Thank you, Leo. It's so inspiring to see these images of the third place and we know that because of digital, our customers' engagement with our brand begins before they ever set foot into the store. It extends into the store experience and continues

even after they leave. And this is what we call the fourth place. It's really one of the biggest reasons I joined Starbucks about a year ago.

Good morning. I'm Emily Chang and a quick self-introduction. I started my career with 11 years at Proctor & Gamble, where I immersed in brand management and consumer insights. Then I was really excited to move to Asia, where I led Apple retail marketing for the Asia-Pacific region. And in the last four years I've been able to serve as the chief commercial officer for IHG looking after a portfolio of 7 brands and really focusing on that digital engagement.

So with a collective 10 years working in China, I thought I would start off today by sharing a little bit about the digital landscape here. You have all heard that China is different. And I guess let's try and talk a little bit about what's different.

Let's start with a practical. For instance, you guys have YouTube and we've got Youku. You've got Google and we've got Baidu. You've got Amazon and we've got Taobao. Essentially, everything digital in China rolls up to 3 Internet giants we refer to as BAT; Baidu, Alibaba and Tencent.

So what's the meaning behind the fact that we're in a pretty integrated space here. Let's look at an example, WeChat for instance, the social platform on Tencent. With 1 app I am able to access all the functionality of the suite of apps in the U.S. So just you can imagine the convenience of going to 1 place and having everything you need in that ecosystem.

In addition to this integration, we're essentially a non-cash community. What does that mean? When I go out for my run on Saturday morning with my mobile device, I've got my running app, I've got my health monitor, I've got my music, my e-book and my wallet if I want to stop for a cold brew on the way home.

On the other hand, Packaged Facts shares that 79% of American consumers are still making monthly cash payments. Now that's a pretty material difference. And with being non-cash, delivery is ubiquitous here and it's part of our everyday experience. So we order our food, both prepared and fresh. We order our personal care with a tap of an app. I can have my masseuse meet me at 9:00 o'clock tonight at my door -- and I'm thinking that sounds like a great idea.

We can order anything. Our family actually ordered our pet bunny Mochi on Taobao and she was delivered to our home. So this is a little bit about what it's like to live in the China digital ecosystem. We call it OMO, online merges with offline.

In the States you might have heard the phrase O2O, which is online to offline or offline to online. The reason China is blown by an O2O model is the two implies you're starting in one place and then moving to another. But actually it's a fully integrated experience, right? If you're online you're already looking for offline stores. If you're in the store offline you're searching online for social commentary on what

you might be considering to buy. And frankly, if we're not delivering an OMO experience we're not meeting our consumers' needs.

Here's another buzz word coined by our partners at Alibaba, new retail. Daniel Zhang, group CEO, calls it the harmonious integration of online and offline. Again, this is digital marketing meets ecommerce meets traditional retail bundled together to innovate new brand experiences.

So why does OMO and new retail resonate so well here in China?

Our consumers are truly digital natives. Here are a couple of statistics to bring that to life. For instance, 29% of Chinese consumers, their purchases are influenced by social compared to globally, 13%. 41% of Chinese consumers receive their promotions via social, compared to 34%. And here is a big one. Absolutely true. My husband is one of these people. 52% of consumers shop daily or weekly on their mobile phone. My next-door neighbor receives 10 to 15 packages a day, compared to globally 14%.

So as you can see there's some pretty big differences from the integration of platforms, to being essentially a non-cash community, to looking at the lives and the behaviors of digital natives. Let's transition now from the digital landscape to the Starbucks digital flywheel and let's start with loyalty because this is all about the power of our brand.

Chinese customers love Starbucks, they love it. When they're carrying a cup it's like a badge of honor. And when they walk through the doors of our store, there's a feeling that they've made it. This is an incredible privilege for us and a deep responsibility.

You may know as well that the My Starbucks Reward Loyalty Program in China is different than in the States. It's a paid membership here. And nearly 7 million customers are actively engaged with us, paying to become a part of our community. This is a really strong connection and it often starts in store between the barista and the consumer. It's a really meaningful relationship that sometimes runs very deep. But in the last four years our membership has actually tripled. This is a really fast growth rate and it's continuing on because for us this isn't about buying one-time trial. This is true loyalty. It's about human connection and it doesn't end there. We take that relationship in the store and we extend it into the fourth place. We engage our consumers, our customers. And our valued members with personal and delightful content. Did you know that 90% of active app users are using our app. Loyalty members are using our app.

So how do we get to this level of engagement, where we have these 90-day loyal members that are actively engaged with our app? Well let's go back to OMO, online merges with offline. Like in the U.S., Chinese loyalty members can receive benefits like a free birthday drink and stars with every purchase. In addition, we bring it into the store. So we have an annual members' night where we invite 5,000 of our most

loyal members to about 150 of our select stores and we recognize and we reward them. We celebrate with them. So they check in digitally and often you'll see like this customer here, she immediately shares, "Guess where I am tonight?" They enjoy the sense of community. It's not just online, it's real, it's offline. It's with our baristas, coffee tastings, as well as with each other. This is about community and connectedness.

And it's not just this loyalty event because we also have an annual coffee festival that extends across all 3,200 stores. Last autumn we had over 50,000 customers join us in coffee tastings all over the region and this really comes back to our core purpose of being. Starbucks is a different kind of company. We celebrate individual customer needs. And the customer always comes first.

You might have heard this statistic that in China we have about a quarter of the stores of the U.S. and about half the active members and growing. Again, this tells me that our brand is strong and engaged and beloved. And it's my amazing job to strengthen and nurture these shared moments of genuine connection because Starbucks is an experiential brand.

We spent nearly 20 years in China creating these moments of connections in our coffeehouses and in the fourth place we can build on that trust to go further. You've probably heard of our social gifting program, Say It with Starbucks. It's a program we co-created with Tencent but it's about so much more than gifting, because if the third place, Leo talked about, is about curated stories and experiences with our partners, the fourth place enables a different sort of community, storytelling, discovery and experience. With, Say it with Starbucks, we come back to the core purpose, creating moments everywhere we are.

You see in Chinese culture there's a bit of an inhibition and sometimes we struggle to share our innermost feelings. Let me bring this to life, as a Chinese American, here is my schizophrenic side. As an American if I call my mom, I would call her and say, "Hi. mom, how are you doing? I haven't talked to you in so long. I love you and miss you." And a Chinese daughter would have the same heartfelt emotion, right? But she would express it differently, she would say, "Mom, it's getting cold out. Are you warm? I just went and bought you some long underwear."

How do we help our consumers express their deepest emotions and when is it most relevant? Well Chinese New Year is not only the largest human migration in the world, it's also the most emotional holiday we have in China. It's when we all go home and see our families. This year over Chinese New Year, Say it with Starbucks reached out to our customers and we asked them, what do you most wish you could say to your parents when you see them this year. But you're afraid you're not going to be able to? What do you most anticipate about going home? And what do you most dread?

And again, because we have such an engaged customer community we received over 200,000 feedbacks overnight. We collected that feedback and shared it back

out in the form of an infographic and we shared some interesting facts with our community. For instance, did you know that more than half of you guys have shouted to a celebrity "I love you" but only 18% of you have told your mom and dad you love them?

You told us that the #1 thing you wish you could tell your parents this Chinese New Year is, "Mom and dad, I know everything you've sacrificed for me." This is incredibly deep. And what an opportunity for us to help our consumers express something that's really important to express. So we're really inspired by this.

We took the most desired messages and we turned them into digital gift cards. The bestselling gift card is this one right here. "I understand all that you've sacrificed for me." We have some cute ones as well. "Yes, mom, you're always right."

And some other just really cute and meaningful messages that we were able to help our customers say for the first time to their loved ones, to Say it with Starbucks. This social gifting platform, it's so powerful. It enables shared connections and two-way conversations and this ties back to our core purpose at Starbucks. It's just so powerful and humbling to be able to use this kind of scale for good and it brings customers into our digital flywheel.

See when I send you a Say it with Starbucks you may or may not be a Starbucks customer. But you're going to go into our store to redeem and enjoy your gift and what I love about this is when you do you'll meet our passionate baristas and you deepen that connection with the brand.

And I'm delighted to share that the Say it with Starbucks social gifting is now available also on the Alibaba platform. So whether you use Tencent or Alibaba, our customers are now all able to Say it with Starbucks.

Okay. So sometimes you see a photo like this one and it's a robotic arm and it's called digital. I would like to pause here and say I don't see this as digital enablement. Because to me what matters to me in terms of digital is something that enables a deeper and more meaningful human connection. So what digital enablement enables more human connection? It may not look sexy like a robot arm. But what's really sexy to me is digital payments.

As you have heard we're over 60% digital tender between WeChat Pay and Alipay and when you look at all of our payment types in the store we're 80% cash free. This is an incredible benefit because I know what my customers are buying and I know their preferred payment types, it's a great opportunity to send customized and tailored messages that better delight.

It extends beyond a benefit with the customers as well to our partners. Did you know that on average in a store our partners spend 7.5 hours processing cash? In one month now we're freeing up 30 hours per store to further engage with our customers, to deepen that human connection and to perfect our coffee craft. To me

this is the point of digital enablement. It's not about a robot arm or a driverless coffee, it's about purpose-driven innovation, it's smartly and creatively leveraging digital to tell stories, to engage customers and to share our coffee craft.

Speaking of coffee craft, you've heard of the Roastery and you have probably heard of the AR experience we've created. I'm excited to share it with you later today. And did you know that we've already extended our AR experience to all of our core stores?

Again, speaking of Chinese New Year, this is the Year of the Dog, super cute year, very close to my heart. And we knew that over Chinese New Year this market would be overrun with dogs and we asked ourselves, how do we extend a warm genuine Chinese New Year greeting to our customers as only Starbucks can?

So once again we partnered with Alibaba and we created this -- an experience where a customer walks up to the store, they scan the siren and one of 12 Chinese New Year greetings pops out at them through AR and they receive a digital red envelope, in Chinese it's called the ang-pau and it's the customary gift we give each over Chinese New Year. The digital cash in a red envelope immediately slots into the customer's digital wallet. This is how it looks when you actually walk through the store.

(presentation)

And we've really only just begun, just over the Chinese New Year period that was scanned 8 million times. There's so much more that we can do with AR in-store digital experience. With digital payment we're creating seamless, more convenient experiences, social gifting is enabling those two-way conversations and that connection that we talked about and as we talked about as well, digital payment. Loyalty is starting to really bring the entire digital flywheel to life.

Do you know that even some of our coffee machines in stores are IoT enabled? Imagine the online merging with offline experience that we can unlock. Can you tell that I'm excited to be here and I love my job? And as Belinda said, it's absolutely true. We have to earn this right to be here every day. We have to earn our customer's trust. And I believe that every disruptive elevated experience we create has to be thoughtfully crafted.

I can't tell you how excited I am. I've been asked to lead our delivery experience. And this is going to meet our Starbucks mission of inspiring and nurturing the human spirit. One person, one cup and one neighborhood at a time might I add wherever you are. It's about uncompromising quality with the product. So wherever you are it tastes just like the barista has just handed it to you over the counter.

And though I've just been here about a year, I'll tell you I've spent hours riding on the backs of these scooters with delivery riders. We've ordered hundreds of packages and products. We want to understand end-to-end the experience, what

are the points of delight, potential delight and current disappointment? And I can't wait to share more with you on this soon because I believe our meticulous approach to this really important element of a digital customer experience is going to be delightful, authentic and only Starbucks.

So let's wrap up the fourth place. It's about how we strengthen and deepen connection with our partners, our customers and our communities. Our stores are beautiful and it's about more than the number of stores we open. Digitally, it's about more than the number of clicks and taps and impressions, because it's about the quality of each and every relationship. Authenticity and trust that our customers have with our brand and to me that is our new retail. Thank you.

**Thomas Shaw** {BIO 17370352 <GO>}

All right, everyone that concludes the first half of our presentations. We're going to take about a 20-minute break right here. So everybody get up, we'll stretch, we'll have some refresh sampling of food and beverage for you and we will back to start the second half at 10:00 a.m.

**Operator**

Ladies and gentlemen, please take your seats we are about to begin.

**Thomas Shaw** {BIO 17370352 <GO>}

Welcome back, everyone. We'll give everyone a moment to get seated here. We're all kind of assimilating here. So to kick off the second part of our day here, it's my pleasure to introduce David Hanson, Vice President of China Asia Pacific Channel Development.

**David Hanson** {BIO 20936171 <GO>}

So good morning. I'm David Hanson. And I have the pleasure of leading the Channel Development Business for China and the Asia Pacific region.

For the past three years I've been continually humbled by the way our Chinese consumers welcome and love the Starbucks brand. Each day, Channel Development works to extend the Starbucks experience beyond our retail stores that Leo and Emily worked so hard to create. Channel Development is poised to bring new customers to our retail stores by introducing them to the brand where our stores and locations don't exist today.

I've lived and worked in China for almost 10 years now, previously working for Proctor & Gamble and now Starbucks. I joined Starbucks in 2010 during the early days of Channel Development. I moved back to Shanghai in 2015 to lead our Channel Development business. And today, we've the opportunity to lead the rapidly expanding ready-to-drink market with tailor made beverages for China in China.



Now, you've heard many interesting insights about the rising middleclass and their aspirational lifestyles that does represent tremendous growth opportunity. Let's take a moment and consider what this means through the lens of the ready-to-drink coffee and tea business.

While the China RTD coffee category is worth about \$1.2 billion annually and showing double-digit growth, it's still just a fraction of the size of Japan and half the size of the U.S. Our consumers, primarily drink coffee in the afternoon. But today's millennials are busier than ever. Some of these consumers have actually started drinking coffee immediately after they leave home on their way to the office or at the office. Plus drinking coffee throughout their day.

Disposable income is also on the rise. Chinese consumers born before 1995 spend far more money on travel, entertainment and shopping. Starbucks RTD aligns to these on-the-go occasions and it's becoming even more convenient than ever to find our products. In fact, the emerging convenience store channel now has over 50,000 stores with new stores opening literally every hour. You'll find them in literally every apartment building or office as you travel.

E-commerce is another emerging opportunity. It's becoming a major shopping habit of choice and making shopping convenient no matter where you are. So to better understand the Chinese millennial and our opportunity, let's zoom in on the day of a life of one of our consumers. Let's talk about Tiffany. Tiffany is a 28 year old digital marketing manager working right here in Shanghai for a multinational company. Tiffany is like many other Chinese professionals. She works incredibly hard at her job. She earns a reasonable income. In fact, she earns almost twice as much as she would have earned just 10 years ago.

Her typical day, she starts on the metro. She's drinking one of our new Starbucks Doubleshot and she is skimming the news on her iPhone and she heads into the office where she's ready to take on the day.

This gives her an early start to the day and, besides, there isn't a Starbucks store in her office. Well not yet, it's coming. But because of her busy lifestyle, she's that new generation that is drinking coffee before starting work.

After her morning meetings she'll break for lunch at exactly 12:00 o'clock with her coworkers. On the way back from lunch she'll stop at a newly opened convenience store in her building and buy herself an afternoon pick me up. She will pay for that using Alipay on her phone as she does for almost all her purchase.

Later that weekend her and friends decide to celebrate their hard work and may go to see a movie at a new premium movie cinema. They head out shopping after the movie and they stop by their favorite Starbucks store for a celebratory Peach Blossom Tea Latte.

Tiffany's journey will offer Starbucks more and more opportunities for us to interact with her lifestyle. And there will be more and more Tiffany's in the marketplace. So we're challenging ourselves to create new beverages in new locations in China for China. And with the support of our local strategic partner, (Tingyi) China's largest beverage manufacturer and distributor, we're already addressing key opportunities.

So let me start to introduce our ready-to-drink lineup starting with bottled Frappuccino. Similar to our approach we take with retail, we sat down with RTD consumers to understand their beverage taste preferences and occasion trends. This local insight combined with our China dedicated research and development team led us to introducing 6 tailor made flavors, including Starbucks signature coffee and 2 entirely new to the world, tea blends.

Matcha Green Tea and Black Tea Frappuccino already represent over 20% of our Frappuccino business. We've already heard this is a tea centric culture and so our opportunity for growth in this area is plenty. Consumers love the taste and they love the iconic bottle. In fact, they're reusing that bottle for arts and crafts and in-home decoration.

Since the launch of bottled Frappuccino we've already placed Frappuccino in over 50,000 places of distribution. We have access to distribution in over 200 cities. And we're making it easy for consumers like Tiffany to find our products throughout the day.

In less than two years we've delighted our on-the-go consumer with over 40 million servings. And although we're still a relatively small player in China, we've already tripled our market share and we're the leading coffee brand. For perspective, it took us almost five years to achieve the same sales and market share status in Japan.

With 10 years local expertise we have access to China's elevated premium specialty channels, cinemas, high speed trains, 5 star hotels and of course, your favorite premium grocery and convenience stores.

The success of Frappuccino led us to the recently launched tailor-made Doubleshot. And when I say recently, I mean just 4 weeks ago, we launched Doubleshot as the preferred energy boost to fuel today's busy lifestyle of our millennial.

Starbucks Doubleshot was launched in 4 China exclusive packaging with 4 tailor-made flavors. It's convenient grab-and-go single serve size makes it easy to be distributed across China even as we speak today. These initial flavors are just the beginning. Our China R&D team has a full range of plans to launch new concepts and formulations for future release.

But the opportunity doesn't end here. In fact, I'm proud to announce for the very first time the launch of Starbucks Chilled Cup, arriving on shelf June 12th. Our new Chilled Cup is a premium coffee and tea refreshment in our retail inspired cup. You can enjoy it at home, on-the-go or right now.

Now, I apologize to those of you on the webcast. But you'll have to wait till June 12th and enjoy it in one of your favorite stores. But please enjoy. I've put a few tasting notes here. Pop the little straw out and away you go to enjoy our newest refreshment. I hope you enjoy this as much as I do.

Our new cup combines the most refreshing dairy and Starbucks signature coffee to bring consumers the creamy latte experience with every sip. Chilled Cup has been incredibly successful in Korea and Japan and continues to grow. And we know with the retail connection of this brand, this will be a huge success here in China.

So considering what we've launched in a relatively short period of time, the future innovation plans that we have, we expect our ready-to-drink business to dramatically grow in the next five years. We expect to move from our current 50,000 points of distribution to 125,000 points of distribution. We'll move to being available in around 200 cities to being available in over 400 cities across China.

And we expect to grow from 40 million servings that we've served to date to serving over 200 million servings annually. This is an increase of more than 5x our current business and will clearly establish Starbucks as one of the largest beverage companies in coffee by 2023.

This means Channel Development will clearly extend the Starbucks experience well beyond our retail stores and be a complement to our Starbucks retail stores.

But this is only within ready-to-drink. We now have a new opportunity through our recently announced strategic alliance with Nestle to capitalize on the wide space we haven't even touched today in the areas of single serve, at-home coffee and premium food service. As Kevin shared, this alliance opens the door to accelerate our pace to enter the single serve space and Nestle's established machine platforms, whether it's Nespresso or Dolce Gusto. It also elevates our at-home coffee experience by leveraging Nestle's vast reach and scale through their current business with convenience stores, grocery stores and other established channels.

Importantly, it addresses our significant wide space opportunity in food service, giving us access to premium offices and 5 Star hotels across China. So we're confident of the channel development opportunity, especially when you consider first; we have a strong Starbucks brand in China. Second, we have the right local and global strategic partners to help us win. And third, we have a growing consumer base that's discovering how coffee fits into their aspirational lifestyle.

The in-China for-China channel development opportunity is immense. And I promise you, we're ready to win in China. Thank you.

Now I appreciate your patience because I know you've been waiting for the financial reports and analysts. So without further ado, please I would like to welcome Weiwei Chen, our CFO.

## **Weiwei Chen** {BIO 18793166 <GO>}

Thank you, David. Good morning. Welcome to Shanghai. Welcome to my hometown. I'm Weiwei Chen, China's CFO. I was born and raised in Shanghai and have been working here for the past 19 years. I am a 3-year partner. Prior to Starbucks I was with Young China where I learned a lot about retail from a strong China QSR operator. I joined Starbucks for the love of the brand that I have been a loyal customer for 25 years. I joined the company also for my career goal of being part of a fast-growing business.

The past three years has been a very rewarding and fulfilling journey for me. The numbers on the next slide you will see are the best testament. I am extremely proud to be part of the team that contributed to this outstanding performance.

What I would like to highlight today is that our success is not only attributable to our scale, to our ability to scale and innovate. But also a direct result of our disciplined growth approach.

For nearly 20 years we have been practicing our Kung Fu as we grow. Learn to find the real estate, recruit and train the right people to open stores, build relationships with the local government and community. We repeat the same for each new store we build and each new market we enter. We have in place a stringent investment approval, monitoring and reporting processes and cross-functional collaboration mechanisms to address any performance issues. As a result of this, I see many of you are taking photos. As a result of this very disciplined approach our business is in a very healthy state.

We have had tremendous growth on both top and bottom line over the past four years. The biggest driver behind such growth is our store development, which grew from 1,000 stores back in FY '13 to close to 3,300 today. We also achieved fantastic comp growth. China comps have stood in the mid-single digits for the past 34 consecutive quarters.

We are in people business serving coffee and continuing to elevate our partner experience is the most important investment we make. As you can see here, in the top two charts, turnover in our retail and support center partners is much lower compared to industry average. This is one of the reasons behind Starbucks China being awarded employer of choice multiple years. This also means that our investment helped to retain a very stable workforce, enabling us to deepen the partner and customer connection.

At the same time, the benefit of low turnover helps to improve our labor productivity and efficiency when coupled with scale growth. The bottom 2 charts, as you can see here, show average store headcount and (IPL) both improved double-digits respectively in spite of our (salivative) store development pace, which required us to have partners hired, trained and in place to operate new stores.

As I mentioned earlier, our China growth is largely driven by store development and it will continuously to be so in the foreseeable future. Over the past five years our overall store cash profitability significantly improved by more than 800 basis points to 39%. This kind of result can only be achieved through a very disciplined approach.

Looking at first year new store cash profitability and ROI, you guys have to agree with me they are best-in-class performances. Not to mention that these numbers were achieved while we accelerated our new store development pace.

In addition, you can see that our first -- our new stores in top tier cities continue to generate very healthy returns, while lower tier cities benefit from better labor and rental structure are generating even more impressive results.

I can't stress enough how hard our retail partners worked to achieve this kind of returns, particularly when they have to leave their families to open new markets. These economics give us the confidence and credibility to continue to execute our store development strategy, go wide, go deep.

As you just heard, we're going to accelerate our store development pace by 20% from 500 new stores each year to 600. We look forward to entering to 100 new cities in the coming five years where we can bring our Starbucks experience to even more Chinese customers.

Now, let me talk about our largest category beverage, which accounts for more than 70% of our sales mix. Over the past four years we have seen this category growing at a CAGR over 30%. While our core and our seasonal category -- our seasonal mix are growing very strong. What I would like to highlight is brewed coffee and tea categories, those still small in mix but have been our biggest growth drivers.

The growth of our brew coffee category has been the result of our intentional coffee forward strategy. Today almost a third of our portfolio is coffee forward stores. The AUVs for these stores are on average 20% higher for the same age class and have on par profitability compared to same age class core stores, despite higher investments for the elevated customer experience. Our coffee-forward strategy is working in China. We want to continue investing in this strategy.

The launch of our Teavana Iced Shaken Tea platform over the past couple of years has helped to drive the growth of our tea category. Our Chinese customers love this new innovation, which combines our core iced tea, with the unique freshly steeped fruits that is useful, refreshing and relevant to their taste. I encourage all of you to really try this new innovation while you're here.

In addition, tea is actually a strong brand recruiter, about 17% of our new customers first Starbucks purchase is a tea beverage, as tea is an approachable, welcoming beverage to the Chinese customer.

We see Teavana as a viable platform to grow our brand appeal and the Roastery Teavana innovation gives us great confidence to continue to grow this category.

Let me now turn to some of the growth opportunities that we're working on, which will deliver very exciting results for us.

Let's talk about dayparts. Chinese dayparts are quite evenly spread throughout the day. This is actually a unique advantage in terms of asset utilization. Unlike the U.S. dayparts, where morning is 50% of the mix, we have the ability to better deploy labor throughout the day. We can also avoid investing extra store equipment that are required to beat the peak hour capacity needs. We have seen an emerging faster morning daypart growth as our customers are developing their morning coffee ritual. To expand this daypart we are building more stores closer to offices and residential communities that can bring morning convenience to our customers. In addition, we are increasing food offerings that specifically target to this daypart. Our bakery products and Greek yogurt cups are big hits. Today, we see a much higher morning daypart mix for top tier cities due to a more developed coffee ritual and higher Starbucks store base. We believe that the morning daypart mix will continue to grow while we expand into lower tier cities as consumption behavior catches up to top tiers over time.

Let us talk about East China. East China by far is Starbucks' largest investment. The East China integration will allow us to scale faster and help to prioritize investments holistically across China.

Let me highlight a few areas of opportunities for you. We see opportunity and leverage the East China talent pool that has strong operation expertise we can deploy at national level to accelerate our growth. We can also leverage our branded Starbucks China University training and development programs to benefit the entire 45,000 partner population.

Furthermore, we see synergy in partner investment programs that enable us to make holistic decisions at national level to continue to elevate our partner experience. We see synergy in the supply chain as a result of combined skill. For sourcing we can drive upstream commodity management in terms of price competitiveness and quality management. Let me give you an example. Today 2/3 of the East China procurement base has different suppliers. We see opportunity to integrate the 2 supplier bases over time, which can give us significant cost advantage.

Through more synergistic supplier management we can also execute better on our food safety goal standards to deliver a consistent brand experience. Our logistic network we see synergy introducing competition through logistic provider selection and more optimized planning for distribution centers and delivery routes.

As we advance our China digital flywheel we can leverage the combined market to seamless deploy programs like delivery, MOP and MSR personalization. We see opportunity in speed to market now that we no longer have to rely and negotiate

with the former JV partner. Furthermore we see opportunity in cost efficiency as there is no longer a need to duplicate investments in 2 markets.

For marketing, we have moved from 2 seasonal campaigns to 1. We can move from 2 official websites to 1 integrated site with better presentation and cost efficiency. For market insight we can reduce redundancies and analysis, consumers research and reporting.

We see opportunity to integrate 2 full programs leveraging Starbucks R&D capability. We believe our China R&D lab's new innovation can benefit the East China market to provide our customers with relevant and consistent food offerings. As a matter of fact, the East China market has a larger morning and lunch daypart compared to rest of China. This gives us opportunity to bring better breakfast and lunch food programs to the East China market to fully leverage and grow these 2 dayparts.

I am certain there is more out there for us to uncover as we go deeper over time. In a nutshell, the East China integration will enable faster decision making, faster execution of roll-out, better cost efficiency where we have a unified market. With all the China growth strategies my peers highlighted earlier, we see immense growth opportunity for East China. Again, we are only five months into East China integration, there is much more learning ahead of us. I am happy to report that the first five months business is stable so is the East China organization. The China team is committed to make this integration a success.

In conclusion, we see tremendous growth opportunities ahead of us. We will continue our strong store development strategy to further penetrate in key markets and expand into lower tiers. We will continue to work hard on our third place, digital and out-of-home innovations to delight our Chinese customers and drive growth; at the same time applying our disciplined growth approach in all investments and executions to take us to the next level.

On the basis of FY '17 actuals, which include East China as a joint venture, we expect, there should be a next slide -- we expect China's revenue to more than triple and operating income to more than double by the end of FY '22. This is a very exciting time for China. The China team is both energized and committed to deliver these growth targets. And I am eager and proud to continue elevating this team through this historical growth in China.

Now, let me introduce John Culver, our Group President, International Channel Development to talk to you about building an enduring company in China. Thank you very much.

**John Culver** {BIO 15817924 <GO>}

Good morning, everybody and first off I just want to take this opportunity to welcome all of you to Shanghai in our first ever Investor Day in this market. I would like to remind you that not only are you in China. But also in Shanghai, where we

have more stores than any other Starbucks city around the world. And it is just the beginning of what is going to be the largest market for Starbucks that we operate anywhere in the world.

I hope that over the course of this morning you've gotten a sense for the type of company that we are building and the type of business that we have been able to build over the last 20 years. And more importantly, the tremendous work that the team has done here over the last five years to really accelerate the growth, to do it in the right way. And to really bring to life through our partners this love, this passion, this sense of family. And the sense of belonging that has made Starbucks one of the most admired and respected companies doing business in China today, whether it is a Chinese company or whether it is a multinational company. It's something that we are very, very, very proud of. And it is something that we take very seriously.

I also hope that you walk away, not only from this morning. But more importantly as you go through your day-to-day, as well as tomorrow, this sense of the opportunity that we have for Starbucks' growth in China. We have outlined for you. And you will get a strong sense, as to why we believe Starbucks has decades of growth ahead of us here in this strategic market.

I also hope that you understand that the team that Belinda and the leadership team has assembled here is world class, unlike any other leadership team that exists for any retailer doing business in China. It's their depth of experience, it's the knowledge of the Chinese customers, it's their unwavering commitment. And more importantly the way in which they have been able to elevate the 45,000 partners and build that passion and pride in creating a great Starbucks experience for our customers each and every day. It is built on the mission and values that have made Starbucks a great company and it is something that is at the core of our success and will continue to be at the core of our success here.

I have no doubt in my mind that China will continue to lead the way for Starbucks as the fastest growing market with an unprecedented growth opportunity, where we will have tens of thousands of stores one day and we will definitely be the leader for Starbucks globally.

Now, before I take the opportunity and go into the Q&A with everybody and I know you probably have a lot of questions. I wanted to take this opportunity to take a step back and to zoom out a little bit. So that you can understand how the immense China opportunity fits into the bigger construct of the CAP region as you know it.

So the CAP Region consists of China, it consists of Japan. And there are 14 other markets that we operate across this region. 3 of the top 5 largest markets for Starbucks sit in this part of the world in terms of store count, in terms of revenue, in terms of operating income. And in fact, CAP, the segment, represents our highest margin segment we operate in the company outside of Channel Development. And we're just getting started.



Across the region, we have 122,000 partners who serve 21 million customers a week. We have over 8,000 stores. And as you have seen through our performance, these stores and these markets perform very, very, very well. And if you look at the overall growth rate across CAP in the most recent quarter, we grew revenue an astounding 54%. When you take and you normalize for FX and you normalize for equity adjustments, we actually grew (13%), leading the way for the company.

More importantly, two years ago, we outlined for you growth targets that we would achieve by 2021. In December of 2016, we talked about our ability and belief in CAP that we would deliver what we called a triple double 2x revenue growth, 2x store count growth and more than 2x growth in our operating income across these markets. We are well on our way to achieving those goals. And we will update those goals in December when we are together in New York.

Now as you look across the region, there are 3.5 billion people that live in this part of the world. 30% are under the age of 29. And the GDP growth in this part of the world is an astounding 5%. Really the themes that you'll see are really in 3 key areas. First, the increasing growth of consumer spending, the rising middleclass, the rapid urbanization that is taking place. And the strong sustained economic growth that is expected for the foreseeable future.

There are going to be millions of new consumers who are going to add trillions in spending power over the next few years in this part of the world. And as their aspirational lifestyles expose them to new brands, to new experiences, many of them will be coming to Starbucks for their very first cup of coffee. The strong growth, the momentum across the region, is going to drive the future growth for Starbucks as a company around the world.

Now, let me drill in to a few of the markets in particular that I'd like to share with you. And let's first talk about Asia Pacific, okay? Asia Pacific consists of 14 markets, from Singapore, where we opened our first store in 1996, to our newest market, Cambodia, which we opened in 2016. Across Asia Pacific, we operate 3,400 stores and we have over 40,000 partners.

A key statistic here is we are opening a store each and every day in Asia Pacific. And our stores, similar to what we're doing in China are pushing boundaries in terms of the design, in terms of the coffee and beverage innovation. And more importantly, in terms of the partner experience and the customer connection.

Moving to South Korea, South Korea, we opened our very first store in 1999. We were a joint venture partnership with Shinsegae group. Not many people know but South Korea is our fifth largest market today. We're approaching 1,200 stores and our system sales exceed way over \$1 billion. What is really great about Korea is the digital experience that they have been able to create. And in particular they were the first market to introduce siren order, which is actually the first evolution of mobile order and pay as well as Starbucks Rewards in this part of the world.

Today in Korea we have over 4 million My Starbucks Rewards members and we are increasing membership 30% a year on a year-on-year basis. Last month we introduced voice ordering in Korea. And the initial reaction from our customers from the market overall has been far above the expectations that we had.

Now, another market that not many people pay attention to is Indonesia. And we see a tremendous opportunity for growth in Indonesia. We have 330 stores. GDP in Indonesia is expected to grow 5% this year. And the overall population is 270 million, expected to be 270 million by 2021. And that represents about 13% of the total Asia Pacific population. Indonesia is an opportunity for us to continue to accelerate our growth.

Let's go to India. India, as many of you know, has demonstrated very strong GDP growth from 5% to 8% historically and projected to do that over the next several years. India, 1.4 billion people. We now have been in this market for five years. We have over 110 stores and we just opened our seventh market and city in India. Similar to China, where we've been here now for 20 years, we are taking a very long-term view on India. And we believe that if we can continue to focus on building our brand the right way, building the connection with our customers and our partners the right way, that one day India will be one of the top 5 largest markets for Starbucks that we operate in the world. I have no doubt.

Now, let's talk about Japan. Starbucks Japan was the very first international market outside of North America. This year we celebrate 22 years in Japan. And we operate more than 1,300 stores across all the prefectures in Japan. In Japan we're focused on continuing to expand our store footprint. We've now accelerated the growth of our stores and are opening over 100 stores a year in that market.

We've elevated our core offerings and we've made investments in the digital flywheel. We recently launched Starbucks Rewards in September. And during that time from September to the point we are now, we now have over 2.4 million Starbucks Rewards members who have entered that program, which has far exceeded the expectations. And in the most recent quarter, we delivered positive comp in Japan for the first time since 2017.

Going forward, we're going to continue to focus on how can we continue to accelerate our growth in Japan while capturing share in that strategic and major market. Still a big opportunity in Japan. Now, I often get asked the question by people of what has made Starbucks successful in this part of the world. And what has been the secret to our success. And it's very simple. And I think you're going to see this over the course of the next two days.

At the end of the day, the reason why customers continue to return to Starbucks. And new customers continue to seek the Starbucks experience is because of our people. It's our partners who deliver an unparalleled Starbucks experience each and every day to the customers that they serve. And it's literally one cup at a time.

If you think what Leo talked about. And you talk about the Brew Bar, we are actually educating Chinese customers one by one on what high quality is. And our partners are at the center of bringing that to life. And it's because of that we have been able to create and demonstrate that Starbucks is much more than a coffee retailer. We are humanity, we are community, we are connections and we offer a daily dose of optimism in a third place where anyone and everyone is welcome.

Our transaction levels in this part of the world have never been higher and we see a continued opportunity for upside. And nowhere is the Starbucks experience alive and well more so than right here in China. And you will see and experience that, Starbucks has cracked the code in China in a way that few other brands have been able to do so. But we recognize that our past success is not an entitlement and we have to continue to earn the trust, the respect, the loyalty of our customers and the love of our partners each and every day.

Throughout the 20 years that we've been here, we have strived to build a different type of company and I am very proud to say to Belinda, to the leadership team, to the 45,000 partners here in China I am incredibly proud of what you have been able to build, the way in which you bring it to life. And more importantly the way in which you represent our company. And represent the mission and values that we hold so dear. Thank you very much.

Now I have also had the opportunity to work in this part of the world to lead the CAP region over the last 12 years for the company. And I can honestly say and unequivocally say that our China business has never been stronger, our aspirations have never been greater and our future here in this part of the world has never been brighter. And we commit to you that we will continue to grow this business the right way, we'll commit to you that we will continue to drive this success of the business to make everybody proud, our partners, our shareholders, our customers. And each other.

So thank you guys so much for being here, thank you for making the investment to travel here, this is an historic moment for our company here in China. And we're proud to have you all here to be a part of it. So thank you.

So with that what we're going to do is we're going to go to Q&A and what I'd like to do is invite the leadership team to come up and join me as well as Scott and Kevin and then we will get into Q&A session all right?

## Questions And Answers

**A - Thomas Shaw** {BIO 17370352 <GO>}

So we have 2 runners with a mike that are running around.

**Q - Unidentified Participant**

(Steven Jurn, Baird) My question is about the East China business, I think you shared some very impressive metrics on sort of the low returns but I think that was excluding East China. So I was wondering if you could maybe just directionally even talk about what the returns on the new units in East China are so that we can frame up sort of how to think about that and then perhaps -- if you think about 600 units a year let's talk about how many -- what proportionate could come from East China versus the rest of China.

### **A - Unidentified Speaker**

I'll take the first part David and commit that when we come back in the December Investor Day we'll give you an update of all of mainland China including East China store metrics, you can imagine with the integration going on we're getting arms around all of the return. And we know the market pretty well but we really want to make sure that we can give you the right level of historical performance and current performance for East China. So we'll do that in the December Investor Day, we just want to run the market for a couple of more quarters and as far as the growth opportunities maybe I'll turn that to Belinda.

### **A - Belinda Wong** {BIO 17337899 <GO>}

The new stores are performing pretty well and will continue -- I am very pleased to say that we are track on our new store growth this year as well, even though we are five months into the integration. So what else do you want to on Weiwei on the

### **A - Weiwei Chen** {BIO 18793166 <GO>}

I think the question was, how would you be balanced in between the 2 markets in terms of stores, I think we work making sure that we capture all the opportunities executing the -- executing our strategy in terms of the go wide and go deep. So obviously, now having combined market and to take into consideration will not be separate -- instead of setting separate targets rather setting targets holistically for China.

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

Thanks, it's John Glass from Morgan & Stanley, 2 question what is -- just got -- just very basic one how what is the percentage of profits that come from China today if you pro forma it for the acquisition, we all done a back of the -- math envelope but I just-- envelop math but I just want to make sure it's right. Secondly, when you talk about the expansion with -- it's all right in unit growth, how do you think about tiers of cities so what's the current estate from tier 1, 2 to the -- through the fifth tiers and where is that incremental growth coming, is it pro rata or are you're pushing more into lower tier markets because there is a greater opportunity to grow vis-a-vis let's say the larger tier markets.

### **A - Kevin R. Johnson** {BIO 3773960 <GO>}

Thanks John, I'll take the first part we haven't broken out specific profitability of the market for China what we've talked about is revenue growth in that 20% range driven primarily by new stores and with operating income growth slightly higher

than that but we haven't actually given specific profitability at their country level and as far as maybe the tier cities Belinda, do you want to talk about that?

**A - Belinda Wong** {BIO 17337899 <GO>}

Yes, I am very excited about new store target, we have had a strategy to make sure that we focus on the key markets in China and we're going to continue to do that because it's important that we continue to nurture and build the brand in the key strategic markets. And the lower tier cities, as you can see the economics are doing fantastically well for us and it's such a privilege for the partners -- for the customers to be to now really waiting for Starbucks to enter their city and we have a certain percentage of going to key markets, which is a majority and then we are not going to just go chase after store counts we are going to do that in a very disciplined way winning in our brand and in China. So I'll let Leo to talk a little bit more about it if you want anything to add.

**A - Leo Tsoi** {BIO 19965066 <GO>}

Thank you, Belinda, actually Belinda was just sharing about the 100 store, 100 city entry in the next five years and pretty much all of this 100 cities are in the tier 5 as we define it. So what it means is every year we're going to bring the brand into another - around 20 cities of this tier 5 cities that are entering into. And as Belinda just said, all these cities requires are patience and discipline to grow because it typically take a few years to really work with our customers and the market there to (view) the coffee rituals and gradually we can see the acceleration of a city of that scale.

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

It's John Ivankoe, J.P Morgan, the question was on opening 600 stores a year and obviously we understand when you put in mobile order and pay in the United States there are some operational changes and maybe some physical changes that needed to happen in the U.S. store base and delivery is another complication perhaps to add the store design and store operations as well. So the question is when you do contemplate these 600 new stores a year, how much are going to be specifically optimized for mobile order and pay and delivery capability. And the question is also how easy or difficult is it to begin a retrofit some of your current estate to some of that next generation digital new type of an issuance which were clearly where the market is going?

**A - Belinda Wong** {BIO 17337899 <GO>}

Great question. I have the privilege to run the market that I opened 600 stores and I only have 3,300 right now. So I can do whatever I want on the new stores. So meaning that I am building my new stores with the space and -- all ready for our future innovations to make sure that we're spending on investment wisely. So in terms of the future MOP or delivery we've already thought about that and how we could allocate the space and make sure that that investment the first time its covering the basic infrastructure at the store and the service level that we needed to have. So and I think you heard us say many times today that running China is real -- I can't really just describe to you how dynamic it is because we are in 141 cities and it's like running 141 markets. Once you enter you have to nurture. And then you have to

look at each and every market and kind of balance the speed of growth and not too soon and not too slow and we have to do all that to kind of balance it so not only the MOP and delivery. When you look at what we talked about, Nitro, the Avocado platform, we have new stores are being built every 15 hours, that's already thinking about that.

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

Jeffrey Bernstein from Barclays. 2 questions, maybe just one from an industry backdrop perspective being that most of us don't have our feet on the ground here and we don't necessarily have the same third-party data that perhaps we have in the States. So I was just wondering if maybe you could just frame for us just the size of the category that we're talking about, maybe the -- your biggest competitors. But other than your competitors just -- then maybe the categories growing the food-at-home versus food away-from-home, just something to kind of size up the scale of the opportunity that who you're going up against and within what category. And my other question was just on government relations, which I know you mentioned one of the people you pointed to kind of work on that very closely. Just in the current environment, I was just wondering if you can provide some thoughts. How are the relations, how do the maybe your approach here differ from other countries especially now we're seeing lots of U.S. political tension. So I'm just wondering how you guys think about something like that.

**A - Belinda Wong** {BIO 17337899 <GO>}

Talking about the size of the market? Man, I wish I knew because it's every day it's growing. And when I say that the coffee market in China, it's not even possible to size it up but what we've been doing in the last 20 years have been focusing on getting the experience right in our retail stores. But as you've heard today from David, we're now entering into the wide space, right? The on-the-go and also the Nestle opportunity in the at-home coffee. So this is entire coffee space as more customers pick up the coffee consumption habit and then slowly become a daily ritual. Now, remember every city, every person is going through this journey slowly. I just know and my focus right now is to be bigger than the U.S. soon.

**A - Kevin R. Johnson** {BIO 3773960 <GO>}

I would just add the context on that is the consumption and I know we talked about this at the shareholder meeting and it was highlighted again today. Less than a half a cup of coffee is consumed here per day in China across the population compared to much higher levels in the U.S. So the upside -- 300 in the U.S.. So the upside is enormous as we build that daily coffee habit and the daily ritual and the opportunity to really define what high-quality coffee is for the Chinese consumer. And again, go back to the fact that literally we are educating customers 1 cup at a time. And it's amazing to go into the stores and see and you saw it in some of the pictures the level of engagement of customers with their phones, taping the baristas, understanding how to make a pour over, understanding Chemex, or understanding what's the difference between Kenyan or house blend, right? There is a thirst and a hunger here in China with the millennial population to understand that. And I think what we've done, Belinda and her team have successfully tapped into that sentiment. And our partners, again, help bringing this to life through their passion,

their engagement. And their love of coffee. And the way they express it, it is something unique and something very special. So on the government side, I don't know if you want to talk about that.

### **A - Unidentified Speaker**

Yes, I'll take the question on the geopolitical side that you asked. I think, as we've demonstrated in the discussion we had this morning that we've been in this market for 20 years and every step of the way we have been very thoughtful and intentional to build this business in China for China. Do it in a way that is true to our values of taking care of our partners and innovating around things like catastrophic insurance for the parents, healthcare, the exchange programs that we do. And building trust with our partners. And that then extends to our customers coming into China with great respect for the culture and the customers. And so we've built this business on - based on respect for the culture, based on trust. And based on the values that our company stands for. And I believe that in continuing to build this business true to those values will be very helpful to us in the relationship that we have not only with our partners but with our customers and the government in China. That said, nobody is going to be immune to geopolitical issues. But I think our approach is to continue to do the right thing every step of the way and with the belief that we are here for the long-term and if we do the right thing that that will be the best outcome in the long run.

### **Q - Karen Holthouse {BIO 17433865 <GO>}**

Karen Holthouse from Goldman Sachs. So going back to the slide that had the 5-year targets for China that had 3x the revenue but 2x the operating profit, why would operating profit be growing so much slower than revenue? And going back to the prior 5-year target that had operating profit growing in line with revenue presumably China would have had to be close to that to be doing that at the segment level, also what's changed since we got those targets?

### **A - Thomas Shaw {BIO 17370352 <GO>}**

So if you go back to the Investor Day in 2016, I think we said 3x revenue and 2x operating profit. And so now we're saying greater than 3x revenue and 2x operating profit. The reason that operating profit is growing more slowly is really because of the change in the accounting and the JV network versus revenue. So when we take all of that revenue in, when we change the accounting, you get is 100% of the revenue versus under the old accounting method you had some very small fraction of revenue and 50% of profit. So it's just the math and the accounting. The actual margin, when you get into '19 and beyond, we will see margin expansion. In other words, operating profit in China will grow faster than revenue. But as you move from '17, which was under the old JV accounting with almost no revenue to '18 under the fully consolidated accounting with all the revenue, you just get that mathematical impact.

### **Q - Unidentified Participant**

This is (John Connolly from Steeple) I was just hoping you could better characterize some of the weakness in the breakfast daypart. I noticed a lot of your stores don't

open till about 8:00 a.m., which seems a little late given the U.S. typically opens earlier. Is it a problem of addressing the (needs) people are on their way to work? Is it the price point where people are used to picking up a bowl from a street vendor on their way or what is the issue there?

**A - Belinda Wong** {BIO 17337899 <GO>}

Okay. First of all, you have to understand China customers usage of coffee is very different than the U.S. So in terms of the more -- we have 3,300 stores right now and the portfolio of our stores in office buildings which is tailored mostly for our morning business and/or the similar lifestyle -- as the U.S. -- the coffee lifestyle that you have, it's still a small portfolio. And these stores are mainly in key cities like Shanghai, Beijing, Guangzhou. And Shenzhen where big companies will station their offices in these major cities. So it is truly very different. And a lot of our stores, a core majority of our stores are in very prime commercial centers, the shopping malls that were right smack in front of the mall and in fantastic locations. And these malls, although we have separate entrance, these entertainment centers don't really open until like 10:00 even sometimes. So first of all, the fundamental difference is that Chinese customers, right now, using coffee, it's very different and it also has a layer of complexity or differences on different cities and the whole Starbucks journey based on that customer. Does that make sense?

**Q - Unidentified Participant**

(Nick Atian from Wedbush) A couple of questions, #1 is just a clarification. When you talk about 60% digital-- in terms of payment at the store and the 80% non-cash, what's that 20% difference?

**A - Emily Chang** {BIO 17006844 <GO>}

Sure. The over 60% refers to WeChat Pay and Alipay specifically. We've got other payment tender types like digital coupons, Apple Pay, et cetera. So we add up all the different payment types and you'll see them today when we go in the store. That's where we get to the 80%.

**A - Unidentified Speaker**

And credit cards and UnionPay?

Yes, credit cards really is the majority of the 20%.

**Q - Unidentified Participant**

Got it. Then just you talk about the difference in terms of coffee usage between how we think about it in the U.S. and China. Can you compare and contrast the role of the loyalty program in the U.S. versus here in China? It seems to me like the point of the loyalty program is to drive frequency in the U.S. Here it seems to me like it's brand affinity more so than anything else. So let me just compare to contrast it to loyalty programs.

**A - Belinda Wong** {BIO 17337899 <GO>}



I'll start first and I'll pass it to you. So I'm very proud of our MSR program, because -- well, before that, our job in the next decade is to have -- to do 2 things very well. One is to introduce new customers to Starbucks and the brand and start their journey with the brand. And the other half of the job is, once we enter the city and once we touch them, we have to cultivate that relationship with them. So to make sure they enjoy and they go through the Starbucks journey. So our MSR program, a paid program, you heard from Emily, it's something that it's very unique to Starbucks in China, where people see that as a status and they are -- they're using that as a new customer as well as like existing customer to increase the frequency. So you want to talk more about the MSR program?

**A - Emily Chang** {BIO 17006844 <GO>}

Yes. I think whether you're in the U.S. or China, the My Starbucks Reward program is all about loyalty. It's a foundation of our digital flywheel. It benefits multiple areas. One is it certainly does represent the power of the brand. In addition, we also see that we have higher frequency of loyalty members versus non-loyalty, similar to the U.S. A significant piece of our payment tender is also by our loyalty members. I think it's mid 30s in the U.S. and it's about 50% here. So what I would say is our consumers are part of our community and that's really ultimately what it is when we talk about the third and the fourth place.

**Q - Dennis Geiger** {BIO 19694619 <GO>}

Dennis Geiger, UBS. Scott, we touched on this, some at the break and Belinda you just talked about a balanced approach to growth. But can you just touch on the balance of comps and development going forward, thinking about cannibalization, obviously you've had robust development rates in recent years, comps are industry leading. So that hasn't been an issue thus far. But just thinking about how you manage that going forward would be great?

**A - Belinda Wong** {BIO 17337899 <GO>}

This is a real Kung Fu that we have to learn how to do in the past 19 years. And as we accelerate more so, because I think Weiwei touched on it and let me just reiterate. Our growth in China, 75% of that is from store growth, new store growth. And the rest is from comp. So it's really a balancing act in terms of the speed of growth in a particular city, if you want to go in and put a handful of new stores, if you want to win quickly. And but you know that in a very short time it may impact your existing sales. But because we're in this long-term commit -- long-term view, right, our aim is always to make sure that we capture the market share timely, not too fast, not too slow. So that comp -- the balancing of comp, it's how we -- that's how we look at it. So it's interesting. If you think about it, we have 600 stores in Shanghai. Now, if I want to post a fantastic comp, I can stop growing. But no way, you cannot stop me from growing Shanghai. I'm going to go faster too, because this is such a strategic market. But I'm going to do that very thoughtfully and making sure we enter the trading areas, we study it. And we enter. And then we look at the effect. And make sure it is a disciplined growth.

**Q - Dennis Geiger** {BIO 19694619 <GO>}

And maybe one more if I could and Kevin maybe this is for you. Just given the incredible performance that China has demonstrated, what can the rest of the world and even the U.S. learn about the execution, the innovation and the experience in China? If you could just touch on that quick.

**A - Kevin R. Johnson {BIO 3773960 <GO>}**

Well I think as Belinda and the team have demonstrated and as you'll see this afternoon as you do the immersions and visit stores, I think 3 things, #1, the level of store design that they have created is superior to any other market in the world. And so much of what we have been doing is learning and understanding how we can take some of the innovation that they have done in store design and then bring that to other parts of the world. In fact, Andy Adams, who now is running global store development he was -- he came from the team here in China a year and a half to run global store development. So we've actually taken talent that was a part of creating the innovation around store design and elevated Andy to a global store development role. And that's what led to things like the Reserve Bars that we're now building in other parts of the world. It's part of what led to the thinking around the Roastery and Reserve, the Reserve brand, in fact. And what they've done here. So #1 is store design. The second, I think, is the way when they look at food and beverage innovation. And I think food and beverage innovation, we want to leverage -- we're a company that leads by differentiating on our beverage and then we attach food. But we realized that even with our core beverages, figuring out how to stay true to sort of the coffee forward beverage. But then innovate in ways that make those beverages relevant to the market that we're serving. I think they have created a model and approach that we will take you through later today in the product R&D team and you get to sample some new beverages and learn how they do it. But it's a combination of the approach and the way they embrace coffee. But then adapt it to things that are unique in that market. Then, third, digital. Digital in many ways, as Emily highlighted, with Alibaba and Tencent, the whole digital, the pace of digital innovation in China is greater than that in the rest of the world. And so I think in many ways, for example, the work they did around social gifting and embracing social gifting, is an opportunity for us to leverage in other parts of the world. So I think it comes down to the management philosophy that I highlighted in the opening, which is, our job is to make sure that we have given Belinda and her team the resources that they need so that they set up every discipline and function it takes to run a Starbucks and then empower them to do that in a way to bring it to life in China. Knowing that the 3 things that we've got to stay true to our mission, our values and the brand. And what you're seeing is a shining example of what happens when you take that philosophy.

**A - Unidentified Speaker**

Let me just add one other thing, if I may. I think if you go back in history of our time here in China, right, back prior to 2010, we operated China as Mainland China. And I'm sorry, we operated as Greater China. And that encompassed not only Mainland. But also Taiwan as well as Hong Kong. And a lot of the support was coming from Seattle to drive the growth. And to put that into context, back in 2012 and I may have my numbers a little bit wrong. But they're pretty close. We had a total of less than 500 stores in China. We operated in 24 cities. And that year we had opened less than -- I want to say 45 stores. In that time we made a conscious decision to build the

team in China, to make the investments. So that they could make the decisions to accelerate the growth. What did we do? We built the China-based leadership team, #1, #2, we invested in design and store development, which you'll see. #3, we invested in R&D. #4, we invested in technology. #5, we invested in supply chain. And what you're seeing today is the fruits of those investments paying off. And as we look to the future in China and we say, what is the opportunity going forward, we're going to continue to make investments in this team up here to drive the success. And at the same time not only from an infrastructure standpoint. But how do we engage our partners? Okay. 15, what is it -- 15 how many store --store managers. We open 1.5 stores a day in China, right? We're adding significantly to the store manager base here, district managers. We've got to make sure we're engaging our partners the right way. And that is critical to our success going forward. So I just wanted to add that.

**A - Thomas Shaw** {BIO 17370352 <GO>}

We've time for about 2 more questions.

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

Matt DiFrisco, Guggenheim. Quick question I guess, in respect to sort of what we're seeing in the U.S. with the changing of the retail landscape, can you give context here what you're seeing with the 3,300 restaurants and as you describe them they're not traditionally intercepting people going to work. But they're sitting in front of malls and big movie theaters. What are you seeing as far as your potential changeover, the pace of changeover of those co-tenants? Are you seeing more restaurants come in and will there be more competition, direct competition in those lifestyle centers over the next coming years?

**A - Belinda Wong** {BIO 17337899 <GO>}

Right. You can -- maybe you can add that after I give some context. I well -- first of all, China is a developing country, right? So we're very pleased to be able to -- while we're growing in an accelerated pace, we're also entering into these new malls that they're building. And these new malls -- we didn't have -- these new malls didn't exist 10 years ago. There's not a need to overhaul the experience that's what they're building it that is right for now. So when Emily talked about the OMO experience, the new malls that they're building right now is really an entertainment center and there's a lot of interactive activities to bring crowds in. So the good news is in China I don't have a problem that there's a lot of traditional malls as already built in the U.S. like what you have. And I -- and we have to kind of change our model. I'm going in right now to be a part of the entertainment and to bring crowds in so that people can -- it's already integrated in the lifestyle when they go out and with the digital, with ecommerce buy and all that lifestyle.

**A - Leo Tsoi** {BIO 19965066 <GO>}

I cannot agree more. Actually, what we're seeing in the retail dynamics today in China, it is changing very fast. And when we work with the strategic landlords are our partners in the real estate industry, you see that they come to us asking for a differentiated experience, because in today's China retail market people are not just

coming in for a coffee, I mean they come in, they want to sit down for a coffee, because that's the moment when they want to spend time outside of home, outside of their digital or even stay in our store for the digital experience. So what we have been doing is we've been intentionally create a differentiated portfolio. Example is a -- in a recent mall store that we opened in Tianjin, you're going to see them downstairs in the design studio, that is a third store that we opened in the same mall. And what we've been seeing is -- and we're working with the landlord (Cofco) that we intentionally elevate the entire store to a completely different manner and since -- after the opening we are seeing even more coffee occasions and customers come into our store, the new one, whereas our 2 existing ones, 1 downstairs at the metro, 1 the other nearby the cinema, they continue to perform as solid as they were. So it says a lot about the occasion that you're able to create for here, for the gathering. And for differentiation even in the same model we operate.

### **A - Unidentified Speaker**

Quick question, Dave?

### **Q - Unidentified Participant**

Just a question on volatility and managing the business. One of the things that we saw from other companies is they spun off China, there's a variety of reasons that companies do what they do. But one of those is that the business got bigger and as the business got bigger the dependence on that business also got greater and the volatility of that market became -- it jeopardized the algorithm of the host company and so there was a capital markets reason perhaps to split it off. You're going the opposite direction. You're kind of streamlining this to be a U.S. and China retail store in a way. And -- but how does the China team think about managing volatility and then should we just keep our eyes open to the fact that maybe the algorithm will be a little more volatile going forward as China becomes a bigger part of the pie?

### **A - Unidentified Speaker**

I'll go ahead and kick off an answer. At this stage of the evolution in China we felt it was best for us to deploy capital to acquire East China so we could unify all as one company operated mainland China and that's really as recognition that we are in a growth phase right now. And that growth phase we felt was best served by being able to deploy capital and get the kinds of return on invested capital that we're getting and to make the investments for the team here to enable us to take the long-term view in building what we believe is a phenomenal asset for our shareholders. And so that's the decision we made and that's why we made that decision. And clearly, the growth numbers that the China leadership team and CAP, as John highlighted, have been putting up, have been accretive to the overall agenda for where we're trying to take the company. And so I think at this point in our evolution this is going to best serve our shareholders and allow us to capture the opportunity and do it in a way that really empowers this team that you see here today to deliver on the vision that they've outlined for you.

### **A - Thomas Shaw {BIO 17370352 <GO>}**

All right, we've plenty more time for questions during the rest of the day. But this will conclude our presentation and webcast today. And again thanks everybody joining us remotely. So right now, we're going to divide up into 5 groups to go on these experience (booth) stores. So everybody will have their name badges and you'll notice a letter. So some people are lucky A and they will be with me, they will be A through E and this will designate where you are going for both the booth tours but also the store tours around town today. A couple other notes to add. First, let's see, just please note that there will be a couple of booths that will have photo restrictions, including the R&D lab and the digital venture booth so please acknowledge that. We will be back here for a quick lunch featuring Princi food after that, a couple of bonus items I have made the executive decision to allow you guys to dress casually tomorrow. It is 99 degrees out. So you can thank me. And finally, please everybody make sure you bring this tonight to the Roastery, this will be important to getting in. So what we will see right now, there will be a few letters, I think we had A and B and E over here and a D and C. So if you can all migrate that way we can get started with the tours. Thanks again.

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