Morgan Stanley Global Consumer & Retail Conference

Company Participants

- Laxman Narasimhan, Chief Executive Officer

Other Participants

- Brian Harbour, Morgan Stanley

Presentation

Brian Harbour {BIO 19285890 <GO>}

Okay. Thank you. Thank you, everyone. I'm Brian Harbour. I'm the restaurant and food service distribution analyst at Morgan Stanley. First of all, this is a joint forum here, so I just wanted to thank everyone for being here, it means a lot and just a couple stats. Sorry if this sounds like an earnings call. But since 2019, we have 30% more investors here, we have 30% more companies, 65% more meetings compared to our 2019 conference. So thank you all for making it so successful and thanks especially to the team behind the scenes that organized all of this. And now I'm very excited, we're excited to have to have Starbucks here, the new CEO, relatively new CEO, Laxman Narasimhan.

Laxman Narasimhan {BIO 19067074 <GO>}

Well, you pronounced that really well.

Brian Harbour {BIO 19285890 <GO>}

I had some coaching, so thank you. And Starbucks certainly needs no introduction. So actually, if you have any opening comments, I'll turn it over to you.

Laxman Narasimhan {BIO 19067074 <GO>}

Well, first of all, I don't see a drink and this is our holiday.

Brian Harbour {BIO 19285890 <GO>}

Next year, we'll have Starbucks coffee.

Laxman Narasimhan {BIO 19067074 <GO>}

Let's start with that. It's doppio espresso macchiato, and it's inside me now. Well, first of all, thank you all for being here. Starbucks as a company is a very strong brand.

We're focused on human connection. And I think the need for human connection is even more relevant today than it ever was. I've just come out last night of launching our values across our entire company. In fact, it's been a nine-month process of us landing the mission, the promises and the values. And I joined Starbucks because at the heart of it, it's a giving company. If you look at our -- if you just look at our promises, the promises say that for our partners, we bridge to a better future. For our customers, we uplift the everyday. For the farmers, we ensure the future of coffee for all. For the communities, we contribute positively. For the environment, at our best, we give more than we take. And what that leads to at the end of it is, for our shareholders, it results in enduring long-term returns for our shareholders.

I've worked in stores, I've worked in stores in many, many countries around the world, and particularly as you see the environment right now, I've had an international career over 30 years where you look across the public sector, the private sector, and the social sector and it's clearly quite an intense environment out there and the headwinds and what you see there are actually quite large. And we as a company are a company that is a -- we are against violence of any kind, everywhere and all the time. And we're clearly pro-joy and pro-belonging, which were two of the values we talked about as a company. We talked about craft, coffee and what we bring, results, courage, belonging and joy.

And I think it needs to be said at this moment in time because there's no question that what you see out there, the geopolitical challenges are large, there are clearly headwinds out there and just as an example, what you see in areas of conflict with our business in some of those places. Additionally, what you see as a context is, and you've read this in the press and everywhere else and everything that's going on is, we're operating in an environment where the U.S. consumer is slowing. And despite all those different headwinds, if you think about what we stood for and what we talked about a month and a week or so ago about our strategy, which is the Triple Shot Reinvention with the Two Pumps, it's an extremely relevant strategy for the long term. So it'll help us in the long term really realize a large amount of value for our shareholders, for our partners, for our customers, as well as for the communities in question.

Questions And Answers

Q - Brian Harbour {BIO 19285890 <GO>}

(Question And Answer)

Okay. Great. One thing I just wanted to address up front, you created a new committee on your Board. Could you maybe talk about the impetus for that and how we should think about that?

A - Laxman Narasimhan {BIO 19067074 <GO>}

Well, first of all, I think as I've joined the company, governance is obviously front and center on our minds, and we think long and hard about it. And the Board, Mellody Hobson, our Chair, Jorgen Vig Knudstorp is the Head of the Nomination Committee, and I have been working very intensively on how we ensure that we make Starbucks and we continue to make Starbucks a paragon for governance going forward. And so in this world that we're in there are a bunch of commitments that we've made, be it to the environment, be it to the partners, and be it to the communities that we live and work in. And if you look at what's coming with regard to the changes taking place in regulations, in places like Europe, for example, particularly on climate. If you look at the assessments that we've been doing internally on us as a company, we felt it was appropriate to actually put a committee together that would actually oversee what we do in this entire space of environment, partners, as well as of the community and the community impact that we have.

And so in our meetings in July and even in September, we agreed that we would actually put this committee together, which we announced just some time ago. We have Beth Ford leading it. Beth is as you know the CEO of Land O'Lakes. And she comes -- she's obviously uniquely capable and qualified person. She provides the oversight for community -- for the committee. And what she does, along with a Nomination Committee and a Chair, provides us the ability to ensure that we're living up to the commitments that we have made. And so I feel good about it actually and it's going to continue to step up in governance of the company.

Q - Brian Harbour {BIO 19285890 <GO>}

Okay. What surprised you most when you joined Starbucks?

A - Laxman Narasimhan {BIO 19067074 <GO>}

The amount of coffee knowledge people had. It intimidated me, actually, because it's very-very deep inside the culture of the company. But on a more sort of serious note, what surprised me most about the place was actually how partner-centered the company actually is. The strength of the brand and what it really meant. And I think if I think a little bit about the commitment that we have made over time, the ability, the appeal for this brand globally is actually really quite large. And things changed on Starbucks over the course of COVID. COVID was tough on the company. And I think as we came out of it, we recovered from it, it was clear that with the right level of investment and with a focus strategically as to where we would go, we would have the ability to truly capture those limitless potential.

So what surprised me in a very positive manner was what you have to work with. The strength of the partners, the strength of the management team, the base from which the business is starting, the international presence. But even though we were international, we were frankly not fully tapped, let alone international even the U.S. If I look at what's going on in the South or Southeast and our businesses in many of these places, Tier 2, Tier 3 towns, the potential for this brand is actually really quite large. And so I think that if I look at food, it's an opportunity, it's an attached business to beverage, it'll play. You look at the merchandise in stores opportunity. If I look at Starbucks Reserve, over time an opportunity. So there's many things, a digital piece of the business, which I know you'll -- surely you want to talk about. It's really untapped in terms of the full play that we have.

So I think there are several elements of this business that actually have a bigger play and that is at the heart of the Triple Shot Reinvention with the Two Pumps. Productivity, by the way, is the other one that I know we'll touch on.

Q - Brian Harbour {BIO 19285890 <GO>}

Don't worry. We'll get to it.

A - Laxman Narasimhan {BIO 19067074 <GO>}

I'm sure.

Q - Brian Harbour {BIO 19285890 <GO>}

One more general question, I think, your U.S. business did quite well in fiscal '23, you're still driving traffic growth. What do you think is kind of behind that, right? Do you also think perhaps there's just less likelihood for people to trade down to at-home coffee? What do you think has continued to drive that strong performance?

A - Laxman Narasimhan {BIO 19067074 <GO>}

I think first of all, if they do want at-home coffee, we have the number one brand there. So we have presence there with the business there, so coffee clearly is there. I think if you look at the U.S. business, what you now have is a business that through COVID has evolved enormously. I mean, it's got a digital footprint that is much larger than it was. There's a delivery business, which didn't exist, and I think we're just tapping the surface of it. If you just look at the different occasions when our stores aren't open and the demand that we have, and we know this through things that we've looked at and pilots that we run, there is in fact further potential, which we haven't fully tapped into. If you look at the afternoons, we still have play there. But we now have a business that actually is digital. The mornings are obviously at the heart of the business. The afternoon is still a play. We still have geographical penetration in the U.S. that could be large.

But we have a strength with our loyals, with our people who own the app. We have 33 million people now, and it's growing every year. But when we see frequency going up, we have a large number of people we have access to that are not in the 33 million that we haven't fully tapped into. But at the core of it is innovation, product. What is it that people come into the store for? Customization at the heart of who we are. The experience that they get in the stores and what that's about. And if you take all that into account and what the brand stands for, the ability for us to deliver consistent quality mostly, and I realize that sometimes it doesn't really happen. Our ability to do all of that makes us very distinctive in this world. And so that's what I believe is actually going on in the U.S. business and contributed to the kind of performance that we saw last year where if you ignore the effects of foreign currency last year, the FY 2023 we grew at 14%.

Q - Brian Harbour {BIO 19285890 <GO>}

Yes. Let's talk about product innovation a bit. I think one thing you mentioned quite a bit last month was PM daypart opportunities. So maybe talk about what kind of opportunity you see there? What we should look forward to in the next couple of years in the PM daypart?

A - Laxman Narasimhan {BIO 19067074 <GO>}

So if you just look at our business and on the beverage side, it is -- it has shifted heavily to cold. But what we're seeing in the PM daypart is there's even more potential. And it's going to be innovation that is going to be highly targeted that we bring in. We already have the footprint. There'll be a lot of people who say, we're targeting the PM footprint, but we actually have stores and we have the ability and the capacity to be able to do it, including the innovation. So on the beverage side, it's really quite large, possibilities are real. But in addition to that, we have a food attach opportunity. I mean, this breakfast business, which I think we went into reluctantly many years ago, right? All of a sudden, it's a huge business and we're selling a lot. And what we see from our customers is, they would like all-day breakfast. They would like all-day snacking. They would like to find a way to attach our food to the beverages they buy.

And particularly as you think of drive-thrus and you look at what's going on with Mobile Order & Pay, it's much easier to custom attach what we have. So I think there's a real play in the afternoon that we haven't fully tapped into yet, and that's going to require innovation, it's going to require digital, it's going to require customization, it's going to require attach. And we have the capacity and the ability to do it. It's an area for us that will be a big growth opportunity for us going forward, too.

Q - Brian Harbour {BIO 19285890 <GO>}

Do you have a different view of food than some of your predecessors because I think that's kind of ebbed and flowed over the year at Starbucks. What do you think about kind of the food opportunity?

A - Laxman Narasimhan {BIO 19067074 <GO>}

I think, first of all, I don't think it's different. I think the customer has changed. As you think a little bit about the customer going through Mobile Order & Pay or through drive-thru, we're seeing attach rates that are quite high. I think in the U.S. it's two or five that are attaching. But it's not three or five, which, again, would just fundamentally change. It's just the size of that business. I mean, it's already a $6 billion business growing enormously, right? And the opportunity, though, is for us, and particularly as you bring in tools like the warming ovens that are more evolved and what we do with the siren system and how we think about things that we bring in, I think you have the ability to actually create an experience there, too, that's also more elevated.

So the innovation, coupled with what we're bringing in, in terms of the physical footprint, coupled with what we have with digital as well as drive-thrus, and delivery, that is actually adding to the nature of this business. And it'll always be an attach business for us. We're always beverage first.

Q - Brian Harbour {BIO 19285890 <GO>}

I was actually somewhat surprised by the stat that I think you gave 85% of beverage sales are core products, 15% are seasonal/new. Does that always been the case? Do you think that'll change over time?

A - Laxman Narasimhan {BIO 19067074 <GO>}

Yes. I think it's a question of how you think about what core is, right? So what is interesting about this that you take a core espresso and then you have things that you're innovating, particularly with customization, the customization business is really quite large. So think of it as a landscape on which you're painting or a canvas on which you're painting. And I think customization keeps our core at 85%. Obviously, the strength of core is really quite important. And what we do with the others, the other 15%, is we're bringing people in with things that are exciting. And so you will see us continue to do that. But customization, just today, we've just launched four new winter foams, cold foams that you can use for customization. You will see more there in the way that we help people have core, but also bring a twist to the core. And then, of course, you have new products and you have LTOs and so on that we bring people in.

So it has been so but if you look at hot coffee, which is, again, part of our core. The fact that we're rolling out the Clover Vertica is going to mean a much higher quality coffee that is delivered on demand. And that's going to make the core hot coffee better as well. It's still an opportunity for us.

Q - Brian Harbour {BIO 19285890 <GO>}

Right. Yes. Makes sense. Maybe let's talk about digital a bit. I mean, clearly you have a very impressive digital business, right? I go into my local Starbucks and it's clearly quite highly used, right? What -- and you want to double it. So what's going to drive that? What's key to that? Do you think -- you talked about some of these partnerships, what else?

A - Laxman Narasimhan {BIO 19067074 <GO>}

Look, we're on a track, even if you just look at the current run rates. If we just sustain that, you get very close to that. So we're starting from a great base. Secondly, we're actually really changing the metabolic rate inside the company around digital and digital innovation. We're into literally 30, 60, 90 day releases. The team has meetings with me in every six weeks, and we look back and say, what did we say we achieve 30 days, 60 days, 90 days. Where we are at now? What's coming in the pipeline, 30, 60, 90? And so there's a metabolic rate and the way the team is working together that is actually much faster in terms of the innovation that's coming. Some of the stuff you will see and some of the stuff is actually behind the scenes in terms of making a much better recommendation if you're out of stock or something, as an example.

What's going to drive it is, first of all, just the -- we have a huge universe that we're already in touch with. I think in the Investor Day we talked about, if you take globally, it's 75 million members of the Starbucks Rewards, we have some kind of a digital relationship with over 300 million people. So the base exists. Then it's a question of how you ensure that you make offers that make them attractive dopamine, how you ensure that you deliver conveniently, which gets to the business model and how we evolve it. Mobile order pickup as an example. It gets them get into the level of customization that you're bringing in, and then potentially what you do with loyalty, particularly with Starbucks Rewards. And I think this is where this partnership fits in. We've already got a partnership with Delta, and you see what happens. As you go to the week of Thanksgiving and the travel day that existed there that we -- the partnership with Delta obviously meant that there were specific offers to people who were traveling that week, as one example.

We're going to announce two more. One with a hospitality company and the other with another financial institution. That will actually give us further connectivity and base and actually increases value to our loyals in terms of the benefit that we provide them. There are digital businesses that we're incubating even on top of all of this that will actually help us further scale what we do there outside the store. Different profit pools that are available. I won't get into all the details on that. But all this actually tells you that there's a digital opportunity that is actually quite significant. It drives business into the stores, it makes people shop there more frequently, but it also gives us the ability to add more to what they do. That's at the heart of what we're doing.

And now in order to do that, we're -- and you heard in the investor forum that we had, we're working on technology and how we re-architect that. Clearly, the partnerships with some of the leading providers in this space, we mentioned the partnership with Microsoft and Gen AI, the work we're doing with Apple products on how we ensure we bring that into the partner experience, as well as the work we're doing with Apple on -- sorry, with Amazon on payment. All these things put together actually tells you this is a brand that people want to partner with and actually bring to life in a way that we can actually fully capture the digital opportunity as a company.

Q - Brian Harbour {BIO 19285890 <GO>}

And I think some of that also plays into just personalization. So how do some of those partnerships and what you're doing today kind of help with personalization specifically?

A - Laxman Narasimhan {BIO 19067074 <GO>}

First of all, the business is set up for customization, which is actually at the heart of personalization in a physical sense. And that's going to get even more amplified as we think a little bit about what is going on with regard to with Gen AI coming in and how we sort of make all that work. We are still on journey of how we learn more and more about individual customers. I mean there's still work to be done. And I think what it does for us is we're clearly ahead. We built Deep Brew, which is our platform, artificial intelligence and machine learning platform, which we built for five years. Quite forward, by the way, to think about when it was done.

And now as you see this tech change, the architectural change that's coming, the work for us now is to how we then take that across all the data that we have, our partners, as well as our customers, and how we put together pictures that actually give us even more on what's going on with individual customers. So that's the personalization journey we'll go into, which actually helps you, come up with products that you can customize for yourself and make it easier to make. Offers that actually will make you even more loyal and realize more value from Starbucks Rewards. That's the journey we're on.

Q - Brian Harbour {BIO 19285890 <GO>}

Okay. Makes sense. Maybe just let's talk a little bit about store operations and efficiency. What do you think has actually been most impactful so far in the past year? And then what do you think will be most important in '24?

A - Laxman Narasimhan {BIO 19067074 <GO>}

I think, if you look at the work in reinvention, which made complete sense to me when I came. Actually, when I joined, we went through the entire program, and the efforts all made sense to me. And I think you see that in the results from last year, just around the progress we've made with just reinvention. We've invested something like $9 billion over the last three years with a combination of things that we put into stores as well as a partner experience. Almost a third of that is into the partners themselves, which is about 20% of the profit that we generated actually gone into that, which has been a very good set of investments that we have made. And I think what you've seen there is we have been able to put in to the stores some equipment that has been very helpful, portable cold foam blenders, an example, help us with the customization of some of the foams. And we did it just before the summer holidays, so it actually played itself all the way through.

What's coming though is what has been being built is, if you look at waste, we attacked waste quite systematically. There's $90 million of waste savings that we delivered just last year. There's more to come with that, but that was very powerful and good. But really the big thing was what we did with staffing and scheduling. It was very clear to me working in stores that we could do better there, how we match demand with supply, how we get more personalized in terms of what the partners want. We're not fully there yet. But if you just look at what we've been able to do, if I go back to 2020 to where we are now, right, essentially the take-home compensation has gone up for the partners by 50%. And we think by 2025, it's going to, in effect from 2020 be double. Hours are a very big part of this. And the way we work it is actually quite important.

There's a lot more stability, operational stability in the stores. You see tenure go up. It's always up by a year, which is a lot for us. And so traffic and scheduling has been a big area of work. We're not fully there yet and there's more to come. And what we are doing is, I mean, the level of math, the level of technology that's going into it, I mean, we have a large number of shifts around our network. And you got people who want to work for 20 hours, or someone wants to work for 30 hours. So we actually -- it's a very complex set of teams working really hard on how we unpack all that. So there's more to come.

Looking ahead, actually, we should look above the store. The $3 billion productivity program that we touched on, 70% of it is outside the store. I ran the supply chain for six months along with running the stores. Rachel gives me no credit for that, I just wanted to point out. But by the way -- but I was actually running the supply chain. And by the way, attach rates went up and then stock went up. Rachel, just so you know. In any event -- and we obviously got great talent in there, but why did I do that? Part of it was to really elevate that in the company. If I think about innovation and what we can do, lots of great ideas on what we do with tech and innovation. Product has to be available. And so -- but we can buy better, we can flow better, we can store better. And there's really work going in there.

And what is interesting in all that is, we've actually put in place a muscle in the company on productivity. That is, in fact, the engine of what's going to keep driving this going forward. And it's at the base of what we call progressive margin expansion over time. So today there's a language inside the company around where are we at in ideas, who is managing the pipeline, how do we go, there's a review every 30 days on it to say how we make a progress versus not, and frankly, I feel very good about the traction and the progress we're getting.

Q - Brian Harbour {BIO 19285890 <GO>}

If I look at a store with all the new equipment that you've talked about, are you running that with fewer labor hours? Are you able to quantify that at all?

A - Laxman Narasimhan {BIO 19067074 <GO>}

I don't think the focus is to run it with fewer labor hours. The focus is to optimize the labor hours to meet greater demand. So it's a throughput question. I mean there's no question that I know and we know this that if I look at ball crates, so what we have, what we call couch ball, people sitting at home in a drive-thru, coming into the store, looking at the line saying, you know what, I'm not going to do this. We clearly have that. And we're working to make it better.

Q - Brian Harbour {BIO 19285890 <GO>}

At the vast majority of stores would you say is throughput still a pretty widespread limitation in your view?

A - Laxman Narasimhan {BIO 19067074 <GO>}

I don't think it's all the stores, but I think it's in many stores.

Q - Brian Harbour {BIO 19285890 <GO>}

Okay. That makes sense. Just sort of about -- this is maybe a dumb question. Why is the third place model still important, right, given you're mostly an off-premise business today?

A - Laxman Narasimhan {BIO 19067074 <GO>}

Well, just think of it, right? I mean, listen to what's going on today, right? There are people who are looking to find ways to connect. And they do come into our stores, by the way. They do come into our stores. And despite all the misinformation and despite all the over-hyping that is going on, people still come in. They want a place where they can have a warm connection, a conversation, frankly, get product and leave. I understand fully your point around saying there are several people who have moved their behavior into more drive-thrus or online, but the third place actually has quite a relevance, both physically, but increasingly also digitally.

And I keep using the story of my time and working in the stores in Beverly in the south of Chicago with a woman who was in the drive-thru at 7 in the morning on Monday. And I remember opening the window to deliver the customized hot coffee that she had wanted. And the window rolled down and the woman was half made up and had the makeup there. And she looked at me with a combination of anxiety, but also relief to see what she was getting. And I just said, I hope you had a great weekend and I hope you have a great day at work. That moment mattered because I was probably the first person she was talking to all weekend.

And so I think we cannot really take away from this idea that there is a point of human connection and that's what this brand is about. That's why the values we have, the mission we have, the purpose of the brand is big in this. But digitally we're able to do it, too, with what we do with Mobile Order & Pay and others. But messages that you get and so on. And we haven't fully tapped that out yet fully. So I think the third place is a broader definition. I know we used to talk about the fact that people go to Starbucks to connect with others, the reality is people rely on Starbucks to connect with themselves as much as through that connect with others. And I think that's a broader expansion of what our mission is.

And with that, you see the Starbucks at-home and the moment of zen you have at-home, it's the moment you have the drive-thru and what you do later on at work with others as well. So I think it's a broader definition of who we are. The classic definition of the third place, it's a box where I go to meet someone, it's frankly not relevant anymore in this context.

Q - Brian Harbour {BIO 19285890 <GO>}

Yes. Okay. Makes sense. I do want to talk about the cost and margin side a little bit.

A - Laxman Narasimhan {BIO 19067074 <GO>}

Yes.

Q - Brian Harbour {BIO 19285890 <GO>}

On the margin side you said historical margins can be in play over time, right? And I'm not going to put words in your mouth, but if I were to say, 5% seems for sales roughly, maybe 3% to 5% cost inflation over time. Do you kind of get there naturally, and you would say, okay, some of the $3 billion cost program that you've talked about adds to that. What other pieces would I think about there?

A - Laxman Narasimhan {BIO 19067074 <GO>}

I think what we talked about is progressive margin expansion, which comes from a combination of, say, of leverage, which is all the math that you have there. It comes from the productivity programs that we have, which are broad. They are about the store as well as in the store. And also the further enhancements that we can think of the area of revenue management that actually help us overall with the progressive margin expansion. So I think as -- we don't set a margin target or a time, but in the long term, I think you can clearly see how we would get back to the levels that you would talk about.

Q - Brian Harbour {BIO 19285890 <GO>}

Yes. You sort of mentioned this, behind the $3 billion program, part of it is waste, part of it is supply chain. I mean what are the other major initiatives we should be thinking about within that program?

A - Laxman Narasimhan {BIO 19067074 <GO>}

In the productivity program?

Q - Brian Harbour {BIO 19285890 <GO>}

Yes. In the $3 billion cost program.

A - Laxman Narasimhan {BIO 19067074 <GO>}

Yes. So as you said, 70% is about the store that actually looks at everything from procurement to supply to the services that we provide and how we optimize all of it. And there's clearly more in the store, including waste, including looking at how we get much better at bringing in the right equipment that helps us, helps our partners do things more efficiently in the store. So it's literally a comprehensive program. Obviously, you get sales and sales leverage above that, including the G&A, which as you know we did make an investment in, in order to launch the program. And as sales keep growing, you're going to see that number come down over time.

Q - Brian Harbour {BIO 19285890 <GO>}

Right. Okay. Do some of your ESG initiatives help there, right? Like I think you're starting to push more reusable cups. I mean, does any of that make a difference on the margin side, for example?

A - Laxman Narasimhan {BIO 19067074 <GO>}

We are embedding a lot of the sustainability ideas into how we do this. I mean almost every single touch point that we have in the productivity program, there is a question around how do you ensure that sustainability is built into what we do? So it will have an impact there.

Q - Brian Harbour {BIO 19285890 <GO>}

Right.

A - Laxman Narasimhan {BIO 19067074 <GO>}

Waste reduction, for example, is a big way for that to happen.

Q - Brian Harbour {BIO 19285890 <GO>}

Okay. I do want to talk about China a little bit. I think we've all gotten the message that the business is very different than four years ago. And certainly there's a drastically different number of stores there. Today, it is lower volume, it is lower margin, you're still kind of in a recovery phase there. What -- so we know what your store expansion target is. What else do you think is really going to drive China on a same-store basis, perhaps over the next several years?

A - Laxman Narasimhan {BIO 19067074 <GO>}

Well, firstly, it is a different business from where it was pre-COVID. We went to China in 1999 with the idea of actually working to create this specialty coffee industry. And a tea-drinking country, massive tea-drinking country. I heard people talk about how the next China is China. We actually subscribe to that view. And so if you look at where we've gotten after 24 years, we've gotten them to 12 cups per capita. Japan is at 280, which has a big history of tea -- of coffee drinking over the years. And the U.S. is at 380. So we're still in early days. If you look at where we are, you look at our store count, and of course, the stores there are different from here in so many ways. 65% of our stores today were not there pre-COVID. So clearly, it's a different network.

We have a digital business that we didn't have before. We have a delivery business that we didn't have before. We have that now. And so it is, in fact, a very different business. Now we have a premium brand. Actually, we have two premium brands. We have Starbucks and we have Starbucks Reserve, both brands in China, and both extremely well regarded as sort of premium propositions in China. And we haven't fully penetrated where we could be, which we're now in 800 county cities out of 3,000. Shanghai, we have 1,150 stores, I've been to Shanghai. There are many parts of Shanghai we're not in yet. So there's even penetration in Shanghai, let alone Beijing and the other cities in lower down in the place that we're in.

Now, the fact is you've read all the press on China, and about what's going on with the economy and how it is and we see it too. We see clearly that the recovery that we're seeing is perhaps half the rate of what you would expect it to be given what you saw in the fourth quarter last year. So it's recovering and normalizing, but a rate slower than what you would expect. But the long term is very clear. Once you see China work through its challenges, I think you will see in the long term it's a business that is very strong. It's a highly competitive market. You're not going to be wrong. It is more promotional now than it's ever been. You see more discounting and all of it. But at the end of the day, we deliver a premium experience and the market hasn't teared yet like it is here.

Q - Brian Harbour {BIO 19285890 <GO>}

Right. Yes. I mean, is it fair to say that in the near term that's still sort of a choppy market for you?

A - Laxman Narasimhan {BIO 19067074 <GO>}

Yes. It'll be choppy and the recovery will be choppy. But it is normalizing at half the pace than what you would think it would.

Q - Brian Harbour {BIO 19285890 <GO>}

Okay. Understood. International outside of China, I think you've focused more on that in your time so far. In your view what was not appreciated there before? What are some of the markets that you're more excited about?

A - Laxman Narasimhan {BIO 19067074 <GO>}

I think what is underappreciated, first of all, is that actually it is substantial. I mean, a lot of our business is the U.S., but I think we've talked about the fact that international and China are kind of in the same level in terms of the contributions over time. It wasn't so before COVID, but it is so now. I think what is underappreciated was the unit economics in many of these markets. They're actually very strong. Now, we have a different business model, so it's appreciated in a different way, but the unit economics were underappreciated. And I fully recognize that we've got all these things going on and international geopolitics and some of the conflict countries affected at this point in time, but if you look at the long term, the brand is very strong. Unit economics are really strong.

The partner and the culture that's been built with our geographic partners, who we've had for years is actually very strong. And the headroom we have in terms of what we could get to is extremely strong. And the headroom is large pretty much across the board. Latin America, Continental Europe, where it is still early -- I mean surprise to say this, but we still are not really fully where we need to be in Continental Europe. And then you get into, of course, Southeast Asia, where there's a big growth play. The coffee culture grows there. India, where the coffee culture is growing, opportunity there too. And then you look at the Middle East and Africa, notwithstanding the near term, but long term, there's real potential and play there, too. So I think what needs to be appreciated more is the fact that it is, in fact, the third leg of the stool for us in many ways. And we haven't fully tapped into that yet. There's still more play.

Q - Brian Harbour {BIO 19285890 <GO>}

Okay.

A - Laxman Narasimhan {BIO 19067074 <GO>}

Digital is a very big part of this.

Q - Brian Harbour {BIO 19285890 <GO>}

Yes. It seems like it's still quite early relative to some other markets.

A - Laxman Narasimhan {BIO 19067074 <GO>}

Yes. And the platform we're building, the Starbucks Digital Solutions, will help us essentially build this global network across all our different businesses globally.

Q - Brian Harbour {BIO 19285890 <GO>}

Okay. Sounds good. Before we finish up, I was going to do my lightning round questions we've asked to everyone here. Demand backdrop for the year ahead relative to recent trends, accelerate, hold, decelerate.

A - Laxman Narasimhan {BIO 19067074 <GO>}

Last year, we grew at 14% without ForEx. I think the expectations we set in a month and a half ago were at the lower end of 10% to 12%, if you ignored currency. So that will be slower than last year, and I think it's more backend loaded in terms of the overall sort of stronger growth than the frontend.

Q - Brian Harbour {BIO 19285890 <GO>}

Makes sense. And then margins, we kind of know the answer to this, but up, down --

A - Laxman Narasimhan {BIO 19067074 <GO>}

Progressively improved.

Q - Brian Harbour {BIO 19285890 <GO>}

Yes. And then capital allocation, prioritization between CapEx, buybacks, dividends, debt pay down, any change in relative importance of those?

A - Laxman Narasimhan {BIO 19067074 <GO>}

We will invest in the business, OpEx, CapEx, as the needs are. Second, for a growth company, in a growth stock, as you might call it, we actually have a history over the years of maintaining a 50% dividend payout ratio. We intend to sustain that. And then the question of what to do with the rest of the money. I think it depends a bit on cost of capital and what's really going on in the world out there as to whether we borrow to buy back stock or whether we pay down debt. And that's a calculation we always go. Just so you know, stock buybacks are a very small portion of the EPS growth expectations that we set. It's like less than 1% or 1% of the 15% that we set in the long term.

Q - Brian Harbour {BIO 19285890 <GO>}

Okay. Great. We'll end it there. And very much appreciate it. Thank you.

A - Laxman Narasimhan {BIO 19067074 <GO>}

Thank you, and you didn't tell me what your drink was.

Q - Brian Harbour {BIO 19285890 <GO>}

My favorite drink is, I like the Iced Shaken Espresso.

A - Laxman Narasimhan {BIO 19067074 <GO>}

The Iced Shaken Espresso, great.

Q - Brian Harbour {BIO 19285890 <GO>}

Yes. With oatmilk.

A - Laxman Narasimhan {BIO 19067074 <GO>}

Okay. 35 cal. The oatmilk is a little higher, but that's okay. I think you can deal with it. Thank you so much.