# UBS Global Consumer and Retail Conference

## Company Participants

- Scott Harlan Maw, Executive VP, CFO & Principal Accounting Officer

## Other Participants

- Dennis Geiger, Director and Equity Research Analyst of Restaurants, UBS Investment Bank, Research Division

## Presentation

### Dennis Geiger {BIO 19694619 <GO>}

Good morning. I'm Dennis Geiger, restaurants analyst at UBS. And I'm pleased to welcome and excited to have on stage with me Starbucks' CFO, Scott Maw. Also representing Starbucks is Tom Shaw, Vice President, Investor Relations; and Durga Doraisamy, Director, Investor Relations.

So first, Scott is going to give some prepared remarks in a presentation that's being broadcast live and for replay. Then, at the end, we'll jump into some Q&A.

So with that, Scott, thanks so much to you and the team for being here. Take it away,please.

### Scott Harlan Maw {BIO 18637895 <GO>}

Thanks for having me. I'm actually going to stand up at the podium just because I tend to gesture a lot. And I don't want to hit Dennis when I'm getting excited here about what we're talking about.

So I want to cover 2 main topics today over the next 20 minutes or so and then get into Q&A. And the first thing I want to talk about. And I'll kind of sprinkle this throughout the presentation, is the longer-term growth drivers for Starbucks that I think, occasionally, with even our own focus on day-to-day comp drivers, our focus on getting the U.S. business turned back to what we expect, sometimes, we lose sight of those long-term growth drivers that make Starbucks a pretty unique long-term investment opportunity. So I'll spend some time on that. Then I want to go through with about half the time and talk about the U.S. because I think it's important to get into what we're doing to drive comp improvement there. So that's the setup.

If we can get this to advance. There we go. Forward-looking statements, please study those. There'll be a quiz at the end.

Then just some metrics over the last five years. And I think this really tees up nicely the longer-term investment opportunity for Starbucks. So store count, you can see up about 50% over that time frame. We'll open 2,300 stores across the globe. That's a big number. Those stores continue to do better and better on top line across the globe and on top and bottom line in countries like China.

91 million customers, nearly 100 million customers per week coming through our stores. Revenue up sort of 2/3 over that last five years and market cap roughly doubling over five years. So a big long-term investment story for Starbucks. And I think, in several aspects, which I'll talk about in a minute, the best is yet to come indeed and particularly around digital and in China. So we'll get into that.

Okay, next slide. There we go. And the first thing I want to talk about and the first big growth opportunity and something that I think is unique about Starbucks is this combination of experiential retail and the digital consumer -- increasingly digital consumer. So Howard's talked about this for a while but Kevin has really been driving that sort of key sort of operating tenet and strategic tenet for us since he's come in as COO and now as CEO.

And what we've said now for the last couple of years is we think successful physical retailers will have some blend -- some more on one end than the other. But some blend of experiential retail, in other words, giving your customers a reason other than just your product to come into your stores; and a blend of digital engagement with customers. So a way to make it convenient or fun or fast to engage digitally. And physical retailers will be in different spots on that spectrum. But we think, at Starbucks, we play well in both places and there's significant growth in both sides of that spectrum.

So let's talk about experiential retail first. So this is something we've been doing in -- for decades now. It's the third place in Starbucks. And while most of our products are taken outside of our stores to be enjoyed by our customers, there's still a significant amount of activity and products bought and consumed within our Starbucks stores. People come by the millions every week to meet in our stores, to work, to study, to connect, to engage. And I would argue, we would argue that sense of community -- as digital continues to consume more and more of all of our days, that sense of community actually becomes more important. If not more frequent and not as big a piece of the total time frame, it becomes more important, that sense of connection, that sense of a place to engage with others and engage with our partners. And we've been really good at that for a very long time.

And the extension of that for us and a place we're investing quite deeply is what we call Siren Retail. So this is Reserve, Roastery and Princi. We call it Siren Retail just make it a little bit faster to say. At the peak of that is the 2 Roasteries that we have open in Shanghai and Seattle. But also the many, many stores that have Reserve coffees with Clover, Reserve stores that we're opening, we just opened one in Seattle, I'll talk about that in a bit. And the ability to extend experiential retail, to premiumize our product and, most importantly, with 28,000 stores around the world, to remind everyone that we still source, roast and serve the highest-quality coffee that you can get anywhere. And so that is a very important part of what we're doing while we continue to invest and grow the digital relationships that we have.

And so because of the frequency of our customers, because of the size of our ticket and the convenience of ordering and coming into Starbucks, we have a lot of transactions and a lot of opportunities for increased convenience for customers. That's where Mobile Order and Pay comes in. Increasingly, we're opening drive-through locations because that gets at an opportunity and occasion for customers to have a faster experience. And our investment in throughput at peak, which has had a big payoff for us over the last nine months or so, all goes to that kind of convenience side and the digital side of that spectrum. And so what we believe is, if you look in the retail world out there and, certainly, if you look in the restaurant retail world, there's not another brand out there with as many stores at scale that can win on both sides of the spectrum.

I'll talk about where there's opportunity. We haven't fully executed on everything that we can, we haven't always grown as fast as perhaps we'd like to on the digital side. But that doesn't take away from the size of the opportunity. And I think that's important not to get lost in the monthly and quarterly view of U.S. comp. So big opportunity around that spectrum.

Okay. So now let me get into what Kevin's talked about, which is -- can I get the next slide? This thing may not be working. Next slide. There we go. I wanted to spend a little bit of time on Kevin's 6 operational priorities and I'm going to -- again, skew towards the U.S. and China, not to short shrift the other ones. But just I want to leave a little time for Q&A and it's a lot to talk about in 20 or 30 minutes.

So as you know, in the U.S. business, on the next slide, there are 3 main priorities that Kevin has been talking about and having us focus on. The first is using operational excellence to accelerate U.S. comps across all day parts. So the recent success in this area for us was in morning peak. So almost exactly a year ago, over the holiday period, we had a significant slowdown in traffic at peak. It actually turned negative in our busiest stores that had a lot of MOP transactions.

And so what we did is we focused on training on specific roles, on really getting the partners that were in the stores pointed at where the biggest activity was and where the biggest bottlenecks were.

We used lean principles to understand where those bottlenecks were and what the opportunity was to open up throughput there. And really, within about three months, we started to see those comps turn. And they went from negative to flat to positive over a relatively short period of time. And actually, for the last 3 quarters, those busiest stores that had the biggest challenges a year ago have actually grown comps faster than the average. And again, that's that focus around operational excellence. And even in the most recent quarter where our comps were below what we expected, we saw peak hold strong because of that focus.

And what's exciting about this is, about 3 weeks ago, we launched nationally for the first time in about five years, an update to what we call labor deployment, which is an extremely unromantic title. We call it deployment 2.0. But it's really how we position our partners at different dayparts within the store to drive throughput and service our customers. And so specifically, what we had before, what we launched about five years ago, was really more based upon an average product mix, food, beverage, et cetera. And an average daypart mix.

Our stores aren't average. So you can have stores that have 30%, 40% food, you can have stores that have 60%, 70% cold beverage. And you can have anything along that spectrum. And so if you think five years ago, for instance, our food was 15%, 16% of total sales. Now it's over 20%. In some stores, that percentage changed by a factor of 2. It went from 15% to 30% over that 5-year period. Cold beverage as a % of total beverage, five years ago, was in the mid-30s. It's now over 50%. But again, in some stores, that mix has doubled. And yet, we were running the same plays and the same deployment based upon average from five years ago.

And so what we launched a few weeks ago is daypart-by-daypart, store-by-store, mix-by-mix labor deployment that has our partners in the right places at the right time. So we'll take a partner off a support role that they may be cleaning and restocking and we'll put them at the warming oven at peak because we know that store has a high mix of breakfast sandwiches at peak. Or where we might have had one partner on the espresso machine turning around and making cold beverages, we now have 2 partners working back to back, servicing a high-cold-mix store.

And it's only 3 weeks in. So there's nothing to really read out yet on comps. But partner feedback on that is quite positive. We've seen a tremendous amount of enthusiasm because it just makes sense. It frees them up to do what they should be doing. And it makes them a lot more efficient. So again, we use lean principles. We use training. We used a lot of things we used -- learned at peak to sort of optimize that. And it's off to a good start. So that's the first one.

If you go to innovation across food and beverage. So I want to talk a little bit about beverage first and then I'll touch briefly on food. As you think about beverage in Starbucks, we've long had a history of real beverage innovation. And that innovation has always been a mix of, I'll call it, platform innovation, things like Cold Brew, things like Teavana iced tea; and shorter-term product innovation, things like different Frappuccino flavors or specialties that have maybe a 3; or 4-week life span within our stores. We call those shorter product innovation sparks, right? They're meant to go in a longer marketing plan.

And for many years, that worked quite well. But recently, particularly in the afternoon, those sparks just haven't worked well. They haven't paid off. They haven't paid back. Frappuccino Happy Hour is probably the biggest extreme of that not really paying back. So we're going to do very different things around Happy Hour this year. Basically, the Frappuccino Happy Hour that you know is going away. And something new is coming in.

But more importantly, we are now going to use more of our marketing dollars and our marketing time to have innovation around platforms. So if you look at Nitro Cold Brew, it's an extension of the Cold Brew platform that we launched a few years ago. Highly successful, Cold Brew. Nitro is highly successful. We're now testing things in some of our Seattle stores like nitro tea lattes and nitro milk lattes and things that may or may not make it into Starbucks stores. But it's an extension of that core capability that we have, an extension of what customers already sort of know and love and, importantly, in our stores that allows us to market behind those platforms for longer.

So if you've been watching in our stores, the blonde launch that we had in early January, that's been emphasized far longer than most of our product launches because blonde is a core platform for us. We were happy with the way it starts. But what's more important is that emphasis on longer-term, more platform-based marketing. And I give a lot of credit to that to Matt Ryan. But also Roz Brewer who's our new COO, has come in and she kind of looked at the marketing calendar and she said, "Wait a minute. Blonde is the first time we've ever had a second espresso. And we're going to market it for that so that we can get it at these other drinks. I don't think that makes any sense. Let it stay in the stores longer." So we took money from those spark marketing and put it in the platform of blonde. So that's the opportunity. So look for more things in Cold Brew, look for more things around Teavana iced teas. And we think that's a way for us to be able to extend core innovation off those platforms.

Food has been highly successful really over the last five years, off the back of the (Love Lunch) platform but beyond now. So if I just pick a few items over the last year, about a year ago, we kind of reinvented our Bistro Boxes and made them all, I think, at least 20 grams of protein. So they're all Protein Bistro Boxes, a lot more health forward, a lot more substantive for customers. In the better-for-you category, we launched Sous Vide Egg Bites, which are driving meaningful food comps. Then we'll always have a spectrum. In the more indulgent side, we recently launched a chicken sausage biscuit sandwich in the morning. And that's doing quite well. So across the better-for-you and more indulgent spectrum, we're pretty happy with what we see on food innovation. And that will continue.

Oops, I'm going to go back, sorry. I missed the most important one. So this is the most important one on the page. And I want to spend a little bit of time on this. I can talk about the Starbucks Rewards program, if you like, in Q&A. But what I really want to talk about is the opportunity that we see for those customers that aren't in the Starbucks Rewards program to have digital relationships with Starbucks.

So just a few stats. As you know, we have about 15 million Starbucks Rewards members active, 90-day active Starbucks Rewards members out of 75 million customers that come into our stores every month. So that means 60 million customers do not have a digital relationship with Starbucks. What you also know is virtually all of our comp growth is being driven by digital relationships via Starbucks Rewards. And the reason is, because of the frequency and the power of the rewards program, we're able to track all of those transactions and serve up relevant offers through one-to-one personalization and big data that drive a high level of incrementality. And that really hasn't slowed. So this isn't about Starbucks Rewards growth slowing, it's about an opportunity that is at 0 today from a revenue standpoint on customers outside of rewards getting digital relationships.

So what do I mean by that? So that 60 million customer base, there are 3 things we're doing today, 2 that we've announced and 1 that we are investigating so we'll see if it comes to fruition. But just to give you an idea of the things that we're looking at to bring those relationships in.

The first is opening up Mobile Order and Pay to all customers. So being able to -- today, if you -- or a month ago, if you wanted to order ahead, you had to open a rewards account and pre-load a card. Now anyone that downloads the app can order ahead. We're rolling that out. By the end of the year, everyone will have access to it. But today, a select customer base that downloads can order ahead. And when they do that, we obviously have the ability to capture their contact information and give them either in app or e-mail marketing and start to track their spend behavior so that we can then get them into the personalization engine and serve up offers. And so that's just starting. That's Mobile Order and Pay. That's the first one.

The second thing that we're doing is we're reactivating. So I said that 15 million is 90-day active. But there are millions of customers that are 91-plus-day active. And we're reactivating those customers. We've been marketing to them for a while now and having some success in converting them. But we're going to go far deeper. The offers will be richer because we know they pay off. And we're going to try to get that previously active base reactivated.

And the third opportunity. And this is something that we're just investigating, we'll see if we can make it work, is what we call WiFi sign-up. So if you want to use WiFi in Starbucks, we're going to make it easy for you. Enter your e-mail once. Every time you walk into the store, it automatically connects to Wi-Fi. And you don't have to accept the terms and conditions again. That allows you to have the convenience of connection. It allows us to have the ability to have those e-mail addresses.

And so across those ideas and others that we're considering, we've said we'll have several million non-Starbucks Rewards digital relationships by the end of this year. And if you think about that 60 million, I would expect that number to continue to grow at a relatively rapid clip over the next handful of years. And even though you won't see a ton of revenue this year from those customers because we've got to get them in, get them established, validate, start tracking their spend behavior and then market to them, right, that's going to take a little while to build that out.

I think, as we get through next year and beyond, that can become a meaningful growth driver for us. But it's basically at 0 today. So that's a big opportunity. I just want to spend a little bit of time sort of unpacking that for you so that you can understand. If we can get those customers into that personalization engine, we will drive comps. It's just a matter of getting the information and then tracking and building the capability to market to them.

Okay. So global growth drivers. Just a quick comment on China/Asia Pacific. So it's our fastest-growing region. I'm going to focus mostly on China. But all of Asia is growing quite nicely for Starbucks. You've got Korea, which is our fifth largest country, last year, double-digit comps, wonderful profitability in a 50-50 JV we have there. Japan, while the comps have been challenged, overall profitability and revenue growth have been right in line with what we expected in that market. We're going to turn the comp story. But still a really good growth market for us on top line and bottom line. Then, of course, there's China. And there's the rest of Asia that's growing as well. But -- and then there's China.

And what's important to understand about China is just there are 3 big things working in our favor in China. The first is the way we've built the brand over time. So we've been in China for nearly 20 years. Over that 20-year period, we've been really, I'll say, methodical about how we've opened stores and how we've invested in the market.

I think you all know that our benefits package in the U.S. is at the top of the peer set. But it's the same way in China. People love working at Starbucks in China. And that reflects well on the brand and reflects well for our customers. We just recently announced critical care insurance for parents of our partners to take care of some types of expenses that is not covered by insurance. And we've invested significantly in the Yunnan province in improving coffee quality. And sure, we benefit from that. But the vast majority of the coffee that is produced under those improved practices goes to others. And that's the right thing to do.

So over a very long period of time, we've built a really strong brand in China. I think if you were to talk to customers and the surveys that we see, Starbucks consistently ranks at the top of Western brands in China. But I think it's how we've done that and how our partners feel about us and how our customers feel about us. So that's the first thing that we have.

The second thing we have in China is we've got a great team. So the leadership team there is almost exclusively Chinese nationals. They've done a fantastic job building out the store-level teams and the regional managers. Belinda Wong and her team are first class. They're very, very conscious of where they open stores, how they open stores, how they staff those stores, building a supply chain that is safe and on time and accurate and making sure, as we do this acquisition, that we get it integrated right, which is why I've been a little bit conservative in making sure we're doing the right investment in the first year to get that acquisition off to the right start. But China, we doubled down with the acquisition. The growth prospects there are just huge. And that leadership team is the one that's driving it. It's not being driven, certainly, from Seattle.

Then the third thing, obviously, is the massive tailwind that is the economy of China. So highest growth GDP of any major country. You've got -- in a couple of years, you'll have 600 million middle-class customers in China. It's almost double, obviously, the total population of the U.S. And what's interesting about that middle class is not only is it growing at double digits in numbers. But the spend per -- the income per capita within that is growing significantly as well. So unlike a lot of developed countries where if the middle class is growing, it's only growing a little bit, there's almost no income growth, China has both. The number of people are growing. And their disposable income is growing. And so that tailwind is wonderful for us. We wouldn't be able to capture any of it if we didn't have the first 2 things to sort of provide a way to capture it. So that's China.

Siren Retail. So just a couple of comments on this. We just opened in Seattle our first Reserve store. So it has fresh-baked Princi on site. It's got mixology so it's got 3 dayparts: breakfast, lunch and dinner. It had a great first week, 1 week in. What I was actually most excited about was the weekend because, obviously, during the week -- it's in our building. During the week, it was just -- I went down there to get a slice of pizza. And I saw that like half the finance team was down there. So there's a lot of partners shopping it, which is great. But the weekend was strong as well.

So that shows that there's a draw from the community. That's obviously what we've seen in the Roastery in Seattle, 20% comps in that Seattle Roastery last year before launching Princi. And that's the third year of operation. So still really strong acceptance in Seattle.

Then our largest store in the world, which is the Roastery in Shanghai, which -- food, merchandise is a significant piece of that equation in China and, obviously, core coffees. So all the things in Siren Retail allow us to make sure we're investing in and extending premium experience, investing in and extending experiential retail. And we're just getting started there.

We just announced -- Howard was in Costa Rica over the last couple of days and opened a visitor center so people can interact with our -- on the farm that we own, Hacienda Alsacia in Costa Rica, to experience how we grow, how we use C.A.F. E. practices to extend coffee farming and agronomy in origin countries. So that's all gone very well.

Then CPG. So just quickly on CPG, our most profitable segment by a margin. CPG is going under a little bit of a transformation as far as the category is concerned because growth has been slowing, from strong growth really to flat to slightly negative growth in that core down-the-aisle coffee business, packaged coffee, K-Cups, et cetera. Growth for us has still been there because of the power of the brand. So we continue to take share in a market that's slowing. We continue to see the partnerships that we've established with the North American Coffee Partnership we have with Pepsi; the Teavana tea partnership that we have with Anheuser-Busch; and then our Chinese bottled coffee, a partnership with Tingyi, those are doing quite well and provide additional ways for us to grow in a market that's slowing a bit here in the U.S. So lots of growth opportunities in CPG in those partnerships internationally and continuing to take share here in the U.S.

Okay. So I want to talk a little bit -- I'm going to try as best as I can to address the question I get a lot. And I'll try to show you basically everything I can show you that we're able to see around this concept of sales transfer. And sales transfer is what happens when we open up a company-owned store, a Starbucks store and sales and transactions move from one store to the other.

So there's 3 things on the slide I want to point out. First of all, average unit volume in a company-owned store is $1.5 million. And the lighter brown area, that represents the amount of business that's coming from existing Starbucks stores. And we can track that quite accurately by looking at trends, a little bit of MSR data. We know that number. And I'm not going to give you the exact percentage. But I will say you can eyeball it. It's drawn to scale. It's small. Everything else in the darker shade, that's all incremental revenue from existing customers that are giving us additional occasion or new customers. So that's important. I'll come back to that in a minute.

The second thing that is important is we're opening 750 stores. That's a big number. I think a lot of folks say that -- look at that number and say, "Well their comps are slowing. They must be moving sales from one store to another." But the reality is our licensed stores -- and this is so important. Our licensed stores and our company stores are different. They are not the same. It's not like we go into a downtown area and we open 5 licensed stores and 5 company-owned stores and they kind of all look the same.

They're totally different. Our licensed stores are in grocery stores, they're in airports, they're in Target, they're in hotels. Generally, they don't have outward-facing doors, right? They are capturing an occasion that isn't coming from an existing store. Now there are some sales transfer from licensed stores. I don't pretend that isn't the case. But it is just so much different and so much lower. I worry that sometimes we're not getting that message across. So those licensed stores do not look like our company-owned stores.

So we got 350 company-owned stores that we're opening. Company-owned base is about 8,000. And most of those company-owned stores are drive-throughs. So we're going into areas that aren't the areas that you guys are used to seeing around here. We're going into areas where there's less density from Starbucks stores and opening new stores.

So what happens when we do that? So this is a store in Fort Collins -- and I'm going to wrap up, Dennis. So here's a store in Fort Collins, a store in a shopping center, no drive-through, 700 transactions, $1.5 million AUV, great store. I'll take them all day long. We make a ton of money in this store, highly profitable, okay? That's what it looks like.

We opened a store about 2 or 3 miles away, beautiful drive-through, larger store. And here's what happened. That existing store, before we opened it, had 700 transactions. A year afterwards, it had 600 transactions. The new store captured about 1,000 transactions, again, that's the convenience of drive-through. And about $2.5 million of revenue. So this is just one year after. You can see the total transactions in the trade area went from 700 to 1,600 and revenue more than doubled. That's a highly profitable trade for us. And it's all dependent on our ability to target real estate, have a minimal amount of sales transfer. Then I forgot something that's really important. What happens with this new store is it's going to comp at 2 to 3x the rate of the rest of the Starbucks stores. So you're going to have 3 or four years build up of stores that drive outsized comps. If I was to take the weighted average impact of those comps, it's meaningful compared to an average store.

On the flip side, you obviously have negative comps in that existing store, right? And if I take the weighted amount of that, it's is a meaningful number. When I add those 2 numbers together, the lift from the new store and the comp impact from the existing, it nets to basically 0. So what I'm left with -- I just want to go back. What I'm left with is virtually no impact on comps because I have outsized comp in my new store offsetting the negative comps in existing stores. And I'm left with -- one more. I'm left with all of the cash flow from that dark portion there.

It's all incremental. It's all new. On a relatively low-ROI store, high-profit beverage store, high AUV, it just works. We're not falling asleep on this. We're not closing our eyes and saying everything is good. We still look at it store by store. We learn from every store we open. And we make adjustments.

So I'll wrap just by saying balancing the long-term opportunities in China with digital and experiential retail with the need to focus that I talked about in the U.S., as Howard always says, our best years are best -- are still ahead of us. So thanks. Dennis?

### Dennis Geiger {BIO 19694619 <GO>}

Great. Thanks, Scott. Great detail for what is one of the, if not the highest-quality growth company in large-cap consumer.

## Questions And Answers

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

So let's dive into a little bit of what you just went through and then some other questions. Maybe, for a second, we focus on the more near term. So obviously, in recent quarters, Starbucks is putting up still very solid absolute numbers that I think most restaurants would be envious of. But obviously, a little bit un-Starbucks like -- you talked about some of the challenges. Can we go through some of the others? I think beyond the number of total Starbucks doors that are out there, folks wonder about competition, they wonder about brand perceptions. Can you just address those 2 real quick? Then just building on that, just the confidence you have.

Obviously, as we think about comp guidance for the year, assumes a little bit of an acceleration from where we are. Beyond what you just said, the key drivers to get to that, that have you most excited.

## A - Scott Harlan Maw {BIO 18637895 <GO>}

Yes, good questions. So what I'll say about competition, first of all, is we live in a competitive world. What I -- what we believe is the competition that comes for Starbucks really is the collection of those independent coffee shops that also try to extend the third place and have a premium coffee experience. And they've certainly grown. But what I think is important is, as best we can read it and there's no perfect read of this. But we think over the last couple years, away-from-home coffee occasions have probably grown, I'll be generous, 1% to 2%. Meanwhile, we've been growing our own stores at 4% or 5%. We've been driving about 1 point of traffic comps. So we've been growing our coffee occasions by, let's just say, 5%. So despite the proliferation of doors and some excellent execution by some of these competitors, we're still taking share. I think the thing that's important to understand is, as they've grown -- when we have issues, let's say throughput at peak, people used to have to -- if they wanted to find an excellent cup of coffee, they had to walk a few blocks maybe in Boston to find that. Today, often, they can just look out of our lobby window. And when we don't have the right kind of execution and the right kind of meeting customer expectations, I think we lose those sales. And so I think that happened with throughput at peak. And the other thing that gives me some confidence that we're still competing well is our peak has held up. It's 50% of our business. And I think it's our core coffee business that was really at risk. We would see much more continued softness there. And it's just not what we're seeing. What we're seeing is softness in the afternoon. And I -- we believe a little bit of that same customer experience risk is at play there, where we're not really focused on throughput, we're not really focused on customer connection, we have so many other things going on for our partners in the afternoon. And again, customers will vote with their feet if they don't get what they want. So that's the first thing. There's been no degradation in any of our brand metrics. Customer service metrics are actually up year-over-year. Employment engage -- Employee engagement, satisfaction and turnover metrics are better year-over-year. So there's no indication that the brand is softening. But I do think we've you got to execute every transaction customer by customer. What was the second part?

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

As far as the drivers...

## A - Scott Harlan Maw {BIO 18637895 <GO>}

Yes. The drivers.

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

There are a lot going on obviously. What are you most excited about over the next 12 months?

## A - Scott Harlan Maw {BIO 18637895 <GO>}

Yes. So let's -- if we break it down really into those 3 things that I talked about. We were talking before about Kevin's ability to lead a strategy and get us focused on executing at things within that strategy. So those 3 things -- what we talked about is we ended the quarter and we started in January at -- we've kind of indicated about a 1% comp, right? That's kind of the math that you can do. And so I'm not talking about where we are now. But if you think about that, what we need to do is we need to get back to a 3%. And if you consider the impact of what we saw from gift cards, right, that was pressuring the quarter, some of the things that we have in the lobby, those will abate. And what will come through is the things that I talked about around execution -- operational execution within our stores. So the ability to do deployment 2.0 across all dayparts. Then if you look at the digital side of things. So we signed up over 1 million new members in the most recent quarter. It's our biggest quarter. It's the holiday quarter. But if you look at January, those had really not gotten into the personalization engine. So we'll start to go after those. We'll start to have just a little bit of impact as we get through the year from those non-Starbucks Rewards digital members. Then the third thing is around innovation. And again, we're really happy with what we're seeing with blonde. We're really happy with what we're seeing with food. And I think if I was trying to go from a 1% to a 6%, right, I would be a lot more nervous than heading into the holiday with a 3%. Several quarters in a row with a 3%, having a couple of months where we were softer and being --needing to build back across those drivers to a 3%, I think that's something that's entirely achievable for the course of the year.

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

And again, as we think about the most recent quarter where we saw some softness, non-loyalty members, afternoon daypart, I think when you talked about labor deployment, when you talked about throughput, when you talked about some of the innovation around platforms and then what you're doing on the digital side with the non-MSR member, it feels like this is the strategy to kind of address a lot of this and this is a big focus over the next 3, 4, 5 quarters.

## A - Scott Harlan Maw {BIO 18637895 <GO>}

That's absolutely right. And the good news about all of that is we were focused on much of that heading into it. So if I look at deployment 2.0, we didn't launch that to address the afternoon daypart and ideate on that two months ago. We've been working on that for 18 months. The first thing we did was at peak. But the broader labor deployment was always planned. So this is very consistent with where we've been focused. We'll execute across those. And we should see comps grow.

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

Great. I want to jump to digital and mobile, obviously, where you've sort of got a best-in-class platform at this point. What has you most excited as we look ahead? Where can utilization go? What capabilities, what initiatives are coming? The direct marketing, et cetera, if you could just touch on that a bit more because that obviously can be a big driver here as we look ahead.

## A - Scott Harlan Maw {BIO 18637895 <GO>}

Yes. When you look the next few quarters, you really have to look to that MSR, the Starbucks Rewards group of customers. And we continue to drive the majority of our comps with those customers. We're not seeing softness in that customer group. And so I look at continued ability to serve up offers at the right time with in-app suggested selling, the ability to continue to get smarter and smarter with the next likely product for customers to purchase, the ability to get even more personalized with some of the gamification and things that we do, going deeper into those marketing channels. So I look at that as a comp driver. And that feels like that's going to continue for us. We haven't really seen any slowing there. I feel pretty confident, if anything, we could see a little bit more from that customer group. Then where you really get excited, again, not so much for this year but as you get into '19, is the customers that we're not really engaged with digitally. And that's where the real opportunity is there.

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

Great. I want to focus on that My Starbucks Reward loyalty program, over 1/3 of all transactions coming from MSR members. I think growth in member spend has been mid; to high single digits over the last several quarters. Last quarter, you accelerated member growth to about 11%, which is a great number. How do you think about growing that membership base? Is it 10%? Can it be better than 10% year-over-year? I think you've talked about 70 million, the opportunity, as the number of customers. Any sense on how many are potential MSR members? How habitual, et cetera? And maybe they don't have to be given what you just mentioned on the -- given the focus on the non-MSR but...

## A - Scott Harlan Maw {BIO 18637895 <GO>}

Yes. It's a great question. So if I think about the first part, I should have said this before, there are sort of 2 ways we're growing the revenue of that group. We're growing the number of customers. And we're growing spend per member. And so if you look at that spend-per-member number over the last year, it's been in the mid; to upper single digits every quarter, which is a tremendous growth rate from those highly engaged customers already. And that's personalization. Some people ask me, "Hi. is your personalization engine working?" Just look at that relatively small sliver of our customers that are highly engaged. But the way we've been able to grow not only the number of members in that but spend per member is pretty impressive, right? And we can continue to do that. So I like sort of mid-single-digit or better spend per member growth. And I like double-digit member growth, at least 10%. The member growth -- base is getting big. And what we need to do is we need to expand the offering. So could we, for example, have a lower level reward tranche, if you will, where customers don't get quite as much rewards but they get something for engaging with us and we're able to understand and market to them? Then, importantly, outside of the rewards program because a lot of people, they just don't want to sign up for rewards programs. I even have friends that I know how much they spend at Starbucks. And I'm like it's an 8% discount. The airlines and hotels, you get 1% to 2%, right, best case. This is 8%. Why don't you sign up? And it's just people have an aversion to some rewards program. They have aversion to pre-loading the card. So outside of that, through Mobile Order and Pay, how do we get customers into that personalization engine? That's a real opportunity. So I -- that's what I would say. That member base should be able to grow at 10%. We should be able to see spend per member grow somewhere in the mid-single digits. If we do that, they'll still drive very strong comps while that other member base is growing

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

And I think initiatives like the Chase debit and credit cards, opening up the mobile order payment architecture essentially, you could see some conversion from -- certainly, there's the potential for an acceleration from those initiatives as it relates to signing folks up. Is that...

## A - Scott Harlan Maw {BIO 18637895 <GO>}

Certainly. And it's -- important thing -- another thing I forgot to say. The exciting thing is, let's just say, over five years, we're able to have as many members that are non-Starbucks Rewards digital as Starbucks Rewards digital. I'm just throwing -- why couldn't it be millions and millions? Just dream a bit. The real opportunity is marketing to those folks. But a sub-opportunity is moving those people along into the rewards program maybe at a lower level, driving additional engagement. But ultimately, some of those customers will come through to Gold. The part of your earlier question I didn't address, there's a significant number of that 60 million customer base that are like my friends who are coming to Starbucks every day, they're just not in the rewards program. How do we get them aware of the rewards program, a little bit engaged? Then can we move them on through to Gold? If we can't, that's fine. We can still market with them and engage them and give them things that are interesting to them. But if we can get them all the way to Gold, that's the power. So I think that becomes a feeder and an extension of that 10% as the pipeline grows.

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

Then I just want to touch on this non-MSR customer relationship again because it can be powerful, right? You're going from essentially nothing, let's just say, to thinking about the MSR member who's a mid; to high-single-digit spend grower year-over-year. You've got them in the system now essentially. You can direct market to them. Maybe they are not getting the stars if they don't want to make the full conversion. But this can really be a powerful driver, I guess, as you ramp over the next 6 to nine months or whatever it might be.

## A - Scott Harlan Maw {BIO 18637895 <GO>}

Probably a little longer than that. But, yes, I'm super excited about it as we move through 2019. Some of the technology stack that we have to build, we can't completely piggyback off Starbucks Rewards or the personalization there. We've got to do some building out. We have to build history for these customers. The beauty of Starbucks Rewards members is we have all this history on what you enjoy so we know what to offer. That will take some time in order to really actualize that. But the size is huge, right? We're talking 60 million customers. And even if, I think, some skeptical people say, "Well those customers on average are less frequent," they are, there are some of them that are actually as frequent as Gold customers. But on average, they're less frequent. But all I need to do is increase a bit. So if I have a customer that comes in once a week and I can get them to come in 6 times a month and I do that across millions of relationships, that could be a nice comp driver within that 3% to 5% long-term guidance. And the only thing that -- I think if Matt was here, he and I would be -- it's going to take a bit of time to build this. You're not going to see much this year. It will start to build next year. But as we get through the next couple of years, it gets pretty powerful.

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

Great. I want to just touch on food quick. Lots of momentum, contributing about 2 points of comp recently, sales mix over -- up over 20%. Just how impactful can food be? As I think about some of the quality enhancements you've seen in breakfast and some of the partnerships you've been doing with Mercato and other things, as we look down the road, partnerships, acquisitions, organically, can Starbucks be a destination place for food? And can this really continue to be a significant growth engine five years -- many years into the future?

## A - Scott Harlan Maw {BIO 18637895 <GO>}

Yes. I mean, even today, we do have single food transaction things that are happening at breakfast and lunch. So people do come to Starbucks for our food. And I think the best way to think about it is I would expect, over the next five years, we could get to 25%. And if beverage starts growing the way we hope it will, food's got to work really hard to take that share. And so that's a lot more things happening at breakfast with food attach. That's the ability to attach things to iced teas and more better-for-you, more healthy beverages that are open to that -- or more open to that food attach. It's the ability to do things in the afternoon and give people reason to come in. It's the move to fresh. It's maybe some things in select stores around Princi and Mercato. So all of that gives us confidence over the next five years to continue to build that. And as you know, it's super economical for us because most of it is attached. So people are already coming in. So you leverage labor, you leverage rent. And so while it can be gross margin -- put a little impact on gross margin, that tends to be profitable at the operating income level.

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

Great. And we're just about out of time. So maybe the last one. As we think about the long-term guidance recently updated to 12% plus on the earnings growth side of things, can you just talk about that decision briefly? Then the comp guidance is 3% to 5% long term. If we're at the lower end or below that, are there opportunities in the cost structure to sort of hit that earnings target?

## A - Scott Harlan Maw {BIO 18637895 <GO>}

Yes. I mean there's a number of things we're doing this year for the first time. So we've had our work that we've done on cost of goods sold that continues. We're doing some things in the middle of the P&L, off to a great start in the first few months on labor and waste, really digging into those stores that are either too low on labor and waste and adding capability or too high and making sure we're managing that. And Roz has been a great partner in that. And so there are opportunities to go deeper there. The only thing that I talk to people about is, for this year, that 3%, it has a fair amount of those savings in there. So I don't think I would -- it wouldn't be right to look to the operators and say, "Hi. look, if things are slowing, go even deeper" because we loaded them up pretty fully this year. I think as you go further into time, we start to unlock more and more. This is what we've learned as we've gotten the supply chain savings. That's gone on for 3 or four years now. We just see more and more as we dig in. And these start to develop a pipeline. But I wouldn't count on it this year.

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

Well thank you very much, Scott and the team. We really appreciate you braving the weather and coming here. And looking forward to having meetings throughout the day. Thanks so much

## A - Scott Harlan Maw {BIO 18637895 <GO>}

Great. Thank you.