UBS Global Consumer Conference

Company Participants

- Keith Stegner, Analyst
- Scott Maw, EVP and CFO

Presentation

Keith Stegner

It's my pleasure to have Starbuck's here with us today. With us we have Scott Maw, Executive Vice President and Chief Financial Officer and JoAnn DeGrande, VP of Investor Relations is here as well.

What we're going to do today is to start with the Q&A session, or the Fireside Chat. And I will kick it off. But again, please feel free to submit questions. And we can revisit [ph] as we go.

So I thought maybe an interesting way to kick this off, Scott, would be I agree with Matt Ryan, who is the Chief Strategy Officer. And what he said in December. One, if not the biggest questions for Starbuck's, is whether it can sustain growth at scale -- 15% to 20% EPS growth, mid single digit same-store sales, especially after so many years of success, right? That's the big question for me.

And what's also interesting is that it's mostly top-line driven, right? You have a lot of different drivers. And maybe we could start walking through these drivers. So let's talk about digital, thinking of it as a category.

Number one, Express Order and Pay. I like to think of it as maybe the urban drive-through. Can you talk a little bit about this -- this Express Order and Pay? Where it is in test? What the pieces to roll? Any other information you'd like to share on this front because this seems like, potentially, a game-changer to me.

Scott Maw {BIO 18637895 <GO>}

Sure, yes. So we rolled the Express Order and Pay in Portland, 150 stores, in early December. So it's been out there about three months. And I would say it's exceeding our expectations on both financial and quantitative metrics that we have. And as you can imagine, we're watching a number of things including incrementality on comps including incrementality on MSR.

We're trying to make sure we can measure the overall store lift because we think there will be some benefit as the line moves faster, even for those customers that don't use Mobile Order and Pay, that line may move faster. So we're watching all of that. And what I would say is for the first few months, which is, obviously, early in that program, we're really happy with what we see quantitatively.

Then there's the qualitative aspect that I think Cliff Burrows, who runs the Americas business would say is running ahead of what we expected. And I'll split that into two pieces. There's the partner, the employee impact. And then there's the customer impact. And if you start with the partner impact, we expected there would be a learning curve there just as people got used to the difference in how customers interacted with us. But what we're finding is partners really, exclusively, just love it.

And the reason is because when a customer places an order from their phone. So when it comes to Boston, if you live in Boston. And you have auto update on your app, there will be a tab that is called "order." You push that tab, you go through, you build the order, there's some communication up to your nearest store. It says the drink will be ready and your food item will be ready in three to five minutes, five to seven minutes, whatever it is. You confirm it. When you confirm it, it pays and sends the order right into the POS in the store.

So it doesn't go into a POS up in the cloud. There's no separate preparation process. It goes right through the label printer and right through the same drink production and beverage production -- or food production -- and then off to the handoff plane just like every other drink.

And so if you were to walk in and, let's say, you ordered a Protein Bistro Box. And you wanted to change that to a panini, the barista can pull that order up just like every other order that came through the drive-through or through the front of the store and change that and put you on your way.

And so it's just really convenient. So really, what they're seeing is just the speed of line movement and then the same process that they use for everything else. So the partner response has been quite strong. We did send a training video out to them but, really, the training video primarily focuses on what the customer is doing because the customer experience is obviously different.

Then from a customer aspect, we expected there would be learning curve. And people would be figuring out how this all worked. And maybe there would be some confusion as people saw other customers walking up to the front of the store and picking up their drink. But what we're generally seeing is curiosity where those customers are asking other customers what's going on. They're asking the baristas, our partners in the store, what's going on. And so we're seeing a lot of traction and understanding with their customers. And we're pretty happy how it started.

Keith Stegner

So one of the other questions I get to this -- or one of the questions I get very frequently is how do you manage all this? And you highlighted this a little bit, right? This is a customer-facing tech. And the concern that comes up is, again, are you going to have an operational hiccup? Are you going to drop the ball? How do you actually put all this in place without screw-ups, right? Is the tech that the partners have sufficient? I've seen new POS's in the stores. How do you avoid the operational hiccups through this process?

Scott Maw {BIO 18637895 <GO>}

Right. I think there's a few pieces that we have our eye on. One of the things, if you think about customer impact, that we are watching is as we make the drinks and we set them on the handoff plane, we want to make sure the drinks stay fresh. Like beverage quality, we don't want that to sacrifice. If it's start to get cool or waits there too long, we'll remake the beverage. And so we put a little bit of waste in our model -- increased waste, just knowing that customers would try to get there on time. But it might not work out. And again, early days, that waste is running well below what we have in our plan. So I think customers are regulating themselves and trying to get there on time virtually every time.

Then on technology, what I would say is we expected, just like with every app launch, we would need -- do some hot patches to fix the app and. So far in Portland, we haven't had to do that. There's more app capability coming. Right now it's just on IOS and so Android needs to come. And we'll roll out that app upgrade here in the next couple of quarters. But by and large, the technology that supports the app and the order is holding in. And that, obviously, helps our partners so the customers don't get confused and frustrated.

Then technology in the store, it's a really good question. We talked about a little bit on the most recent call, earnings call. But we'll talk about it quite a bit more over the next couple of quarters. We need to make some investments in the stores on what we call "partner-facing technology digital" -- "partner-facing technology." We think our app and other things we do for customers are near the top of the industry. But our partner-facing POS mobile capabilities, app capabilities for scheduling, even simple things like the laptops and the printers in the stores, we've maybe fallen down towards the median on that technology. And we want to be towards the top.

So as we get through the back half of this year and into next year, we'll start to identify and invest in that technology to speed things up. So for example, we're rolling out an upgraded POS. We may choose to speed that up a little bit. And what's happening is Adam Brotman, who is our Chief Digital Officer, is out meeting with partners, really, as we speak, trying to create that list and get some real input on the ground to figure out which of those things do we want to do first.

But for example, we still take inventory in the stores using pen and paper. Eventually, that's got to change. And so we're putting that on the list and saying how quickly can we make that change to make it easier for partners? And all that speeds things up in the store.

Keith Stegner

Is the investment that's required for part of this already built into guidance?

Scott Maw {BIO 18637895 <GO>}

It is. I think a lot of it will be capital. I don't want to minimize it, because we want to make sure we get the right return. But it's in the guidance for this year. Then as we get into next year, we'll just see what we want to do and how fast we want to go.

Keith Stegner

It's been quite some time, maybe almost even a year now that we've been -- I keep asking this question about the ecosystem, expanding the ecosystem. Howard's been talking about monetizing it, ways to leverage this. And maybe starting with the loyalty piece, what can you tell us about evolving stars? It's still one star per transaction. It came up at the December Analyst Day. But we're still on one star per transaction. How do we think about the evolution of that loyalty program? Then once it evolves, like, what are the options to broaden, entrench that ecosystem. Can we bring more people in, get more frequency, more (inaudible). How do I think about this?

Scott Maw {BIO 18637895 <GO>}

If you think about the pieces of the ecosystem today, we're doing things in all three pieces to drive more transactions and more customer adoptions. So for example, the card. Just take a simple example. We had a card wall in most of our stores in the US, where there were up to 100 different cards to choose from over the holiday. So taking up space in the lobby to really promote those cards. And you saw the card sales that we had in the most recent quarter.

So really trying to make sure the card is front and center. The design matters to some customers. So that helped with adoptions. And we had cards gifted at a rate that was even higher than last year's success.

Then we try to work really hard to get those customers to turn those cards into loyalty cards that they load and use with us. And as you know, loyalty or all form of the card as the percentage of payment is up above one third now. And so for every payment -- for every three payments, one of them is made with some form of the card. So we want to continue to drive that.

Then we saw a significant uptick to 9 million active MSR members today in the most recent quarter. And so I think our partners, our marketing, everything that we're doing in the stores trying to get the card out there and trying to get those cards converted into My Starbuck's rewards customers.

And as you know, that's a win for everyone, because we think our rewards program stacks up as well as anyone else's out there. It's really beneficial for consumers, particularly our most frequent customers. And we can learn things about those customers and send them relevant offers, over time.

So driving and trying to find additional ways to grow MSR is critical. And that includes, as you alluded to. And I think Matt talked a little bit about always evaluating the MSR program and thinking of ways that we can change and improve and tweak that. No commitments on when. But you can imagine we're always thinking about that and talking about that.

Then, critically, what can we do with mobile? Mobile payments were at 16% of total payments, which is a pretty amazing number because I think 18 months ago it was in the single digits. So we're continuing to grow that percentage. We want to continue to grow that percentage. We think there's a high adoption rate and, again, it gets people into MSR and into one-to-one marketing.

Beyond that, it gives us a tremendous number of payment transactions, more than any other retailer out there on our app. And we've asked ourselves, is there a way to monetize that? And so we've talked to everyone. We've talked to payment companies and financial institutions and other retailers. And there are discussions that are going on right now. It's a relatively complicated equation for both sides. We bring a lot of value -- the partners we're talking to. If I said the names, you would understand why. They bring significant value and just getting to the right terms is something that's important for both sides so it takes a while.

I think the way that it manifests itself most likely is an ability to earn stars somewhere outside of the Starbuck's store and then use them in a Starbuck's store. But there are many other things going on just given the leadership position that we have.

Keith Stegner

Technical marketing, this has been a frequent topic at this conference, as well, across all those different retail sectors. You've got such great access to your consumer. Are you happy with where your tactical marketing is? Have you really turned this on yet? Is this still a big option for, say, driving incrementality getting those MSR customers back in the store? How do you frame where you are in tactical marketing?

Scott Maw {BIO 18637895 <GO>}

I think it's still early days for us. We had decent capability before Matt Ryan came in. So Matt's our Chief Strategy Officer. But he also runs all of the customer analytics -- analytics that we do even on partner satisfaction. So Matt has a tremendously strong team to help us build this out.

So all the things that you do with direct marketing that have been out there forever that we're able to do more of when our MSR base grows, things like Challenger, Champion, marketing, things like test and control, all that basic things that need to happen to set the model. You have to do a certain amount of marketing to fine-tune it. We're really in the early days of doing all of that and then learning what works best for our customers and for us. And obviously, we know when we get it right because customers will tell us with increased transactions.

And so, I think if Matt was here, he would maybe say we're in the first inning. I might say maybe second or third just because I've seen that team come so far over the last 12 months. And there's always a balance there. We want to make sure we believe we're adding value to our customers. But you don't want to be intrusive. And getting that balance right is important. And we'll always try to be on the safe side of that line, that significant opportunity.

And to your point, Keith, I think it's important -- we think there's significant opportunity to continue to grow MSR. So in the back half of last year, the MSR growth rate flattened a little bit. And we did a bunch of things to turn that around. And we got traction in the most recent quarter.

Keith Stegner

Switching to food, when we spent some time together in the fall, it was very clear that not only were you not disappointed. But you were very pleased with La Boulange and its contributions to the comps. How do you think about this role of food over the next couple of years? Is there still significant room? Is this a check driver? Could it continue to drive traffic, maybe, in some of the off-peak day parts. What's the current status of foods potential to that same-store sales outlook?

Scott Maw {BIO 18637895 <GO>}

I think Cliff talked about, in Investor Day, roughly doubling the size of our food revenue over the next five years. And in order to do that, really, what we need to do is execute on what we're executing on today. So that includes up-leveled food items in the morning. Now, we have the bakery platform all up-leveled to La Boulange. And that's doing great. But even within that, we've launched breakfast sandwiches kind of under that umbrella about a year ago. And they were up 29% this year.

We just launched the new breakfast sandwich, Double Smoked Bacon, that's off to a great start. So there will still be a way, whether it's through SKU swap-out or selective SKU expansion, limited time offers. And food is something that we've done some of. But we think we can go further with that. And all of that will help that morning day part, which is, obviously, the biggest piece of our business. So look for transaction and ticket comps around food to continue to grow in the morning.

Then from a percentage basis, lunch is really the biggest opportunity. Not necessarily dollars but percentage. And we've grown food at lunch over the last two quarters, about 15%. And if you were to decompose Cliff's doubling of revenue, that's probably the range we need to be in in most quarters. Not necessarily every quarter. But somewhere in the teens in food growth at lunch.

And lunch is early days as far as the influence of La Boulange and up-leveling food. I will say over the last few years we've done things like add Bistro Boxes, up-level the paninis. And it's resulted in the afternoon day part, let's call it 11 to 3, lunch and afternoon being the fastest-growing day part for us from a comp perspective in most quarters over the last couple of years.

So even before La Boulange was rolled out for bakery. And we started working on lunch, our customers were already telling us we're relevant at lunch, we're convenient, we have a good food selection. And so I think we have kind of the authority. And there's an appetite there from our customers. And now with rolling out La Boulange sandwiches and up-leveling some of the things we can do on salads and Bistro Boxes, I think we're feeling like even separate from that La Boulange bakery platform, we have built a substantial food capability. And it's early days on lunch.

Then evenings I would argue with 30 evening stores it really hasn't even gotten started yet. And the food platform in evenings is pretty exciting because it's totally different. So it's generally small shared plates. You can still get the food that you can get in the other day parts in Starbuck's but small shared plates in evenings -- bacon-wrapped dates, truffle macaroni and cheese, focaccia bread pizza, things like that. And the ticket in those stores is really mixed. So a small group will come in, someone will get beer, wine, they'll share a small plate or two of food. And someone will order espresso or tea.

Keith Stegner

And just to be clear -- so in those, let's say, slower day parts, evenings, afternoons, leveraging tea, leveraging evenings, leveraging beer, wine, food, et cetera, if we think about that comp trajectory over the next couple of years, if this stuff all starts to hit in adds [ph], it should be a little check, it should be a little traffic, right? It keeps all the pieces of the comps potentially growing, leveraging a slow day part.

Scott Maw {BIO 18637895 <GO>}

That's right. And it's a really good point. So that's all the qualitative stuff we're excited about. If you want to know what we're looking at it, quantitatively, food has been 2 points of comp in almost every quarter or more for the last three years. I would look for food to be 2 points of comp across ticket and transaction in most quarters in the future.

I would expect food, as a percentage of revenue, has gone from the mid-teens to the high teens right now. I would expect it to grow up into the mid-20s over that five-year period if everything works as we expect.

And we do think, particularly in the lunch day part, we're starting to see people come in for lunch and, with the refreshment platform, which I'm sure we'll talk about, with iced teas and refreshers and Fizzio, we have more refreshing drinks that they can attach food to. And on the flip side, if they come in in the afternoon for a drink, there's better snack and lunch options for them to choose from.

Keith Stegner

So switching to unit growth in the US, because it's kind of all those together in terms of impacting comps and maybe cannibalization, how do you avoid brand degradation that's happened for so many others, right? You reach a point where you continue to open units. You go to smaller, more flexible boxes and the next thing you know, woops, we've opened too many, we've been cannibalizing comps. Even though it feels like there's a good new unit return on that box, maybe it wasn't the most helpful thing for the system, right? How do you avoid brand degradation from growing just a little bit too far?

Scott Maw {BIO 18637895 <GO>}

I think the first thing I would say is, as we've added and increased the number of units over the last few years in the US, we haven't seen meaningful cannibalization. So there's still share for us to capture, there's still geography for us to expand into -- maybe not necessarily new cities, obviously, in the US. But within cities I think we're increasingly finding there's plenty of room for more Starbuck's.

And so one of the things that gives us confidence around unit growth is looking at different formats. And small formats are part of that but larger formats are as well. So whether it's a store in Downtown Disney, or a reserve forward store, referencing back to the Roastery, those larger-format stores, coffee-forward stores are going to be part of the mix, going forward.

Drive-through-only stores, which really aren't small format so much as they are just convenience and taking advantage of a pad in an industrial area or a transitional area where we can drive additional traffic.

Then small formats, really mostly in urban environments, where there is an opportunity to either offload from a store that's really busy or, frankly, just pick up foot traffic where, if we tried to put a full-size Starbuck's store in there, it would be difficult to afford and to make it work.

And so with all of that, we understand that we can get out ahead of ourselves with unit growth. And so we're doing a lot of work both on the front end and the back end to make sure every one of those stores is doing at least what we expected in the business case. We dis-aggregate everything. We don't look at anything on average.

We're always looking at the stores that over-perform, what we call the "green tail." Those stores that are maybe a little bit below their target, the "red tail," and we try to understand both. So that we can improve what we're doing from a modeling standpoint.

I do think it's important to understand if you look at unit growth in the US. And even if you look at the most current year, we built about 250 new company-owned stores. And then a couple hundred or so license stores. And so while we're expanding in the US, it's split pretty evenly -- our capital and our partners' capital in stores like Target and Kroger and Safeway and so we're happy to have that distribution footprint. We're happy to get in that real estate that we couldn't get into and get our royalty. And I think our partners are quite happy with what they're seeing.

Keith Stegner

So switching over to more of, like, the operational hookup potential side -- with all this growth you've had, more being added to the stores, more asked of these partners, it's clear they're right at the heart and center of this. Where you talked a little bit about partner-facing tech. But we also had this program about making life better for partners, better wages, more benefits, more self-expression, right?

So if we think about this, Wal-Mart raising wages, you're raising wages, we talked to McDonald's about this a couple of minutes ago -- what's the cost of securing and keeping talent that helps you maintain that service differentiation?

Scott Maw {BIO 18637895 <GO>}

Right. Maybe I'll talk about operational complexity first. And then get to the wage question. So we get a lot of questions about operational complexity. And I think it's no accident that our number-one strategy is about putting partners and coffee first. And making sure that we always remember that at Starbuck's what makes us different is, first of all, our employees in the store. And then the fact that we source, roast. And serve the finest coffees in the world.

And so while we move into these adjacent categories, at the end of the day, we're making sure we reinforce that through the Roastery that we've built in Seattle, through what we're doing with Reserve and Clover, Flat Light that we recently introduced. And so when you look at some of the complexity, if you want to use that word, that we've added, most of it has not been in the morning day part.

With La Boulange we up-leveled the food. But for the most part the items look the same. We were warming breakfast sandwiches before, we're warming breakfast sandwiches now to the extent there's more warming and that, if you want to call that complexity, I guess it is. But it's just additional transactions. And obviously, we earn and put more labor to work in the stores when that happens.

Then most of the other things we've talked about, whether it's Fizzio or Teavana Iced Tea or evenings program, it's really in that lunch and later day part where there's a lot of capacity in the store. So just to get to the complexity, if you decompose it, we think we can manage it and handle it. However, I think we acknowledge that we have to make sure we stay focused on fundamentals.

As far as wage, we talked about significant partner pay and benefit investments back in the October call. And we made those decisions back in August in our budgeting process. We set the money aside. As we started the year, we actually took about $100 million out of our G&A plan out of the run rate and just to make sure we could get those partner investments covered. And we had some FX opportunity that we needed to cover as well. But those decisions were made all the way back in August. And what we launched in January was that exact program that we had planned back in August.

So it wasn't in response to what we saw recently in the announcements that are made recently. And importantly, it wasn't in response to an increase in turnover, a decrease in partner satisfaction. What it really was, as you referenced, is we've long had a lead in total pay and benefits, whether it's health care at 20 hours a week or stock programs that go all the way down to the barista level -- 401K, wages, all of that. And when we looked at that gap that we had, we just decided it was time. We want to make sure we make an investment to hold that gap. So that the turnover benefits, the service benefits, all the things that accrue to us when we get that right, continue.

So that really was the impetus behind that. And so, going forward, I think to the crux of your question, we'll look at that just like we always have. And we've been increasing pay and benefits even before the big investment we recently made. But we just thought it was time to up it a bit. And as we head into the back half of the year, partner digital investments, for sure. Technology facing our partners in the store, that's absolutely going to happen, it's just a matter of what and when. Then we'll always look at the other pay and benefits and determine what we think is right at the time.

Keith Stegner

Switching over to channel development, this is an interesting one for me, because for some reason consensus hasn't entirely brought into the guidance you gave at the Analyst Day -- growing revenues, 60%; operating profit maybe 100% between 2014 and 2019, that's $500 million of incremental operating profit over that period. And consensus isn't there. Can you talk for a second about the opportunity here -- where the growth comes from, et cetera, within this segment? Then I'll dig in a little bit more after.

Scott Maw {BIO 18637895 <GO>}

There's two big growth opportunities in channel development over the next five years. And maybe what I'll talk about is the categories that are significant today. So we have roast and ground packaged coffee down the grocery aisle or wherever, if you want to buy it. That category broadly, has been declining pretty steadily for the entire industry for a number of years now. And that has been shifting to single serve.

What we've been able to do as that category has declined is hold or slightly grow a little bit our number-one share. So we feel pretty good about packaged coffee. It's still a significant revenue source for us. It will be in the future. And we're doing some great things there. So I think we're happy in a declining category to fold our growth share a bit and drive profitability.

The shift to single serve is something that everyone has seen. And we've been participating in that in a big way. We're a leading share in single serve. In the last quarter it was number one. It kind of switches back and forth between us and the number one or number two player that's up there. And obviously, we're at a premium price point down the aisle.

So over the last few years, actually, a relatively short period of time -- Mike Conway, who runs our channel development business has built a leading position at a premium price point down the aisle. And we feel pretty good that that is something that we can continue to do.

And what we're doing today to continue to see double-digit growth in channel development driven primarily by K-Cup is broadening SKU selection. So working with Green Mountain to make sure we have plenty of places to add things like Cinnamon Dolce, to add things like a mocha-flavored single origin K-Cups, which is the first time we've had that.

And the relationship with Green Mountain has never been better. So we're able to continue to get that allocation of additional SKUs, to continue to get the manufacturing allocation that we need. And it's driven a ton of growth and profitability. And I think that continues. I don't think we're sitting there going, well, maybe we've got a couple of more SKUs we can add. And then things are going to flatten out. We think we can continue to drive K-Cup growth over the next few years.

What's going to come online over the next two or three years significantly is there today. But what will increase as far as contribution to total profit growth is international and, particularly, probably the early opportunity is in ready-to-drink. So we're in 21 countries with ready-to-drink, which is something I don't think a lot of people understand. So we have ready-to-drink in Japan; ready-to-drink in Korea; we have a number-one ready-to-drink share in North America through our partnership with Pepsi.

And as we look outside the US, we know that there are other deals that we need to do. We have the recipe capability that we can do, we can make it most locally relevant. We know we have the brand that's reinforced by our store presence in those countries. What we need is the right partner from a production and delivery standpoint, distribution.

And so we're in the midst of talks in countries to try to add ready-to-drink, particularly Asia Pac in a country like China. We think there's significant opportunity. So while that business, from an overall percentage of the total profitability today is smaller, we see significant growth as those things come online. And as you get two or three years out. And you look at the growth in our profitability and what the mix is, it starts to become a meaningful part of it along with single serve.

And so that's why, when you look at the top line. And a lot of that revenue will come through as a JV or a partnership or a royalty like Pepsi does. And so that's why our bottom lines grows a little bit faster than our top line. Some of that will come through top-line revenue. But some of it will come through JV income.

Keith Stegner

This actually brought up a question from the audience. There's been more than one. Talk about the Keurig partnership. Is there room for that to grow internationally? And would you be open to the Starbuck's brand playing part in the cold platform as well?

Scott Maw {BIO 18637895 <GO>}

I think there's room for single serve internationally for Starbuck's to become much bigger than it has been. I think if you look at countries in EMEA, we think there's some things we can do there to increase our share. And in Asia, it's obviously early days for single serve. And so what's the right partnership and way for us to go into those markets?

We believe we're uniquely positioned as a global coffee brand. There's not a lot of brands out there with the retail distribution -- no brands out there with the retail distribution that we have and the consumer mindshare that we have. And so we think that bodes well for international single serve and other CBG partnerships.

And sure, we're talking about all the major players and thinking through how we want to do this and how we want to go about executing it.

What was the second question, sorry? Cold, cold.

I think cold is interesting to us. And time will tell whether there's something there that comes through, whether it's Green Mountain or someone else where we can take some of our products like tea and, perhaps, Fizzio. And do it on cold.

Keith Stegner

As part of the international piece of this, you mentioned, say, Asia Pac and some of the opportunities there. And Japan was a very hot topic when the acquisition was announced. It's going virtually silent in terms of questions to me. Do you think it's being given enough attention by the financial community?

Scott Maw {BIO 18637895 <GO>}

I really don't. You know I'm going to say that, right? I really don't. It's our largest acquisition ever. And we're really confident and excited about what can be in Japan. And we're confident and excited about what can be in the retail stores. So we have 1,000 stores in Japan. When you look at the revenue line item, it's our second-largest country in the world now that we own 100% of it.

So -- there are things we can do in those Starbuck's stores both from a unit count growth, maybe to go a little bit faster than we were with our JV partner. But also in the stores around limited time offers and things that we think we can drive comp.

I do think it's important to point out that Japan's been comping in Starbuck's stores at 4% a year, on average, over the last three years. So that's not consistent every quarter. It moves around. But if you take the last three years. And that's a pretty big number in Japan. The economy has been flattish, it's not -- the retail environment is tough. So we feel good about that. But I think we can lean in and maybe either do that or a bit more.

But the real opportunity in Japan is the channels that we're really not in, or we're in in a small way. So that's licensed stores, ready-to-drink, we've got a nice little business. But how can we expand that? We really don't have a food service business. So office coffee, which is really good for us in countries like the US and Canada and the UK, that's really very nascent. And so those channels, we know how to run them. And now that we own 100%, we think we can open up those distribution channels.

Keith Stegner

This brings up a point I think is interesting, which is you've been cleaning up JV structure pretty aggressively over the last five years, right? You're getting fewer and fewer of them. And there are a couple of major ones left. And while I understand some of them are quite profitable, is this part of an ongoing plan? Could we maybe expect to see continued cleanup of that structure? Or is this more of, like, when options present themselves, you consider it? How do we think about, maybe, the remaining JV structures?

Scott Maw {BIO 18637895 <GO>}

I think it's more the latter. I think it's more when things start to make sense for us. And things make sense for our JV partner, either we've been buying and selling, which I think is your point.

When those stars align, then we sit down. And we talk. And we see if we can get to the right price. There's no master plan that says on this date at this time we're going to buy this or sell this. But I think as we've proven over the last few years, sometimes those stars do align. And when we do we'll do what we think is right.

Keith Stegner

Switching over to operating margins -- you and I have talked about this before. When we think about consolidated operating margin outlook over the next couple of years, the way you often phrase it to me is "several tens of basis points of operating margin expansion for a year," right? You outlined $1 billion worth of cost saves at the Analyst Day or Investor Day over the next couple of years. How do you get to $1 billion of saves within this organization?

Scott Maw {BIO 18637895 <GO>}

The important thing is to understand where we're starting from. So every year for the last few years, even before I came to Starbuck's, Troy sat down with the supply chain and said, "We've seen your plan rollout and the businesses have all of the cost of goods sold that we're assuming. And cost of goods sold is our largest expense, as you can imagine. Now what we want to do is we want to give you a challenge to go and take costs out of the supply chain."

And that challenge has been building a bit every year. But last year it was just under $150 million. And so the billion dollars is an extension in addition to that challenge. And so this year it will be a little under $200 million. And you can see how you quickly progress to $1 billion of run rate.

It's important to understand it's real rate savings. So when that comes in, we give it out to the P&Ls to the business units. And they're counting on the supply chain to deliver it in the P&L. So this isn't run rate, it's not fixed assets, it's not cost avoidance. It has to come out of the current rate level.

And so we think $200 million a year is certainly doable, which gets us almost to $1 billion in and of itself. And I think in the out years we can raise that a little bit and push all the way up to $1 billion. And it's through things that you could guess around, which is increasing our sourcing savings. There's some amount of that that presents itself every year just as contracts renew. But our sourcing team is going deeper and doing a far better job of trying to understand structurally what we can change within Starbuck's. What our vendors need to change. And then how we can drive savings.

I gave the example on Investor Day, which I thought was a good one when we rolled out La Boulange, as you can imagine, Pascal and the team went out. And they looked at all the recipes. And they actually went out to every manufacturer, every supplier of ours. And made sure that they could deliver on the recipes. They were simpler, higher quality, more natural recipes, right? You can recognize the ingredients that are in the ingredients list in our croissant now.

And so what we thought is, given the up-leveling of the preparation, the up-leveling of the product itself, our cost would go up a little bit. That was in our forecast. But what the team did is when we went out there, they actually kind of stripped the entire process down to the studs and looked at everything that was going into the process. And so what we got was a better quality product at a little bit lower price.

And so those are the opportunities I see the sourcing team doing more and more. Then there are opportunities in how we transport goods, moving to more full truckload transportation was we grow. There are things that we can do around warehousing and storing green coffee and transporting green coffee. And all of that adds up to almost $200 million this year.

Keith Stegner

Another area where I think consensus is, say, held back from maybe reaching your targets is EMEA operating margins. Talk about maybe potentially reaching 20%. The consensus is not there. Can you walk through, maybe, is it mix of business franchise versus company? Is it sales leverage? Is that a realistic target? Maybe how long does it take to get there?

Scott Maw {BIO 18637895 <GO>}

I think we can approach 20% in five years, I really do believe it. I don't want to say it's automatic math. So I'll give you the pieces that go into it. It's certainly a mix shift towards licensed stores. Virtually, all the stores will be open -- will be licensed in a meal. We'll start to open a few more company-owned stores, there's still opportunities. A lot of the cost-saving opportunities, Keith, have come out. So things like store closures, re-franchising.

We'll do some more deals around that. But the big early opportunities have been executed on. Kris Engskov, who runs the region and the teams, have done a great job on their own supply chain and COGS. And on support costs looking at what we do in individual countries and what we can do at the center and taking money out that way.

So most of that is in the run rate. And so now it's really about operational execution. And I think perhaps the most encouraging thing we see is we've been in that mid single digit comp rate in our largest company-owned markets. So UK, Germany, France, in most of the last few quarters, it's been that big single-digit comp. It's a tough environment over there. It's competitive, the economy is not in great shape. But we've been able to be in that range most quarters. And I think Kris will continue to do that. And he'll need to do that to drive 20% operating margin.

Importantly, we have to have our licensed stores do well as well. So we need to be able to have our partners wanting to open those units and then operating them well both for their own sake and then for our royalty and profitability. And if you look at an area like the Middle East, with Alshaya, that's growing really well. They've been in high single digits, double-digit comps in the most recent quarter. And that's a fantastic result. And there's 700 or so stores we have with Alshaya. So it's a big partnership for us.

So you add all that up. And you start to do that math, mid single digit comps most quarters, you get the store base growing and licensed stores. And you can get to 20%.

Keith Stegner

Starbuck's recently announced some management changes. The Chief Operating Officer, Troy Alstead, took a coffee break. Kevin Johnson, one of your Board members is taking over as President and CEO. Can you talk about this management change a little bit, maybe the thought process behind Kevin as a great addition to the Board. Just a little bit of color around this management change.

Scott Maw {BIO 18637895 <GO>}

It's a great question. I had a question in my travels around bringing in an outsider with Kevin. And it's the first time I'd ever heard anyone refer to it that way. And we certainly don't think about it that was with Starbuck's. Kevin is a very involved Board member. He understands the company deeply. He's at the high end of involved Board members that I've ever seen. He sits on the Audit Committee, the

Compensation Committee, he's a local in Seattle so you'll see him in the office having discussions with Adam Brotman around digital strategy. So Kevin has just been really engaged in the over five years he's been on the Starbuck's Board. So he's one of us.

The entire senior leadership team knows Kevin and has worked with him in one fashion or another. Obviously, him being on the Audit Committee, I've worked with him a lot. And so it's great to have someone that knows the company and that we know. He obviously brings tremendous technology expertise. I think it's important to understand Kevin has a massive amount of international operational expertise.

So what he did with Microsoft, obviously, being CEO of Juniper. And I can already feel how he's thinking about driving that forward, picking up a lot of the things that Troy started as COO around prioritization, bringing the operations together with technology and supply chain around a little bit smaller leadership table so we can go deeper and faster on what we want to work on and how.

Troy did a fantastic job of that over the last year. And Kevin started asking me about how do we continue that before he even started. And so he's all over that. So I don't think we'll lose a lot around how we were operating as the COO team, if anything. Then I think there's huge upside around technology and operations moving forward. And he's been in the role three days already. And I've had a couple of discussions with him, several e-mails. So he's fully engaged. I think Howard said it best. And I think we feel the same way, it's like having a number-one draft pick. That's the way we feel with Kevin, he's just going to be fantastic.

Keith Stegner

We have a couple of minutes left here. On the capital structure. So thinking about optimal capital structure for the company, I think most people in this room would like to see a little bit more leverage in the mix, et cetera. When you think about that optimal structure maybe what's the path to get to a target? How long? Over what time period? What's a comfortable level? Then within that, how do you balance dividend versus repurchases in that process?

Scott Maw {BIO 18637895 <GO>}

I think I'll start with dividend, because that's really the linchpin. Our dividend payout policy is 35% to 45%. We've been moving up within that range. There's a chance over the next few years to continue to move up within that range. When we look at the dividend and we compare it to other growth companies, if you take growth rate and dividend payout rate, we're certainly on the upper right of that chart.

So we feel like we have that right. But the dividend is important to us. And we'll continue to grow it and perhaps we'll grow it a little faster than earnings as we have in the last few years.

Then from a capital buyback standpoint, sorry, stock buyback standpoint, we've been increasing that really to get at the dilutive effect of our broad-based share compensation plan. So we're committed to that. In the last year we leaned in on that a little bit when the stock was down a bit in the Third Quarter of last year. We bought well above anti-dilution. And we'll be prepared to borrow to do that as needed.

The trick with us, as far as debt goes, is cash levels onshore. So it's likely that cash levels offshore for us build a bit. But because all of our debt service, all of our dividends, even though that US business throws off a massive amount of cash flow, I can promise you, that's where everything has to come from and so, likely, we'll borrow some amount every year to fund all of the capital activities we have going on.

So we think that likely adds to our leverage a little bit. Maybe it adds to our leverage ratio a little bit. But we don't have a targeted leverage ratio where we say add A [ph] minus, under S&P we can issue billions of dollars of more debt. We're not marching towards that target. What we want to do is make sure we keep the capital deployment going on dividends and share repurchases. And then that will lead to some debt and maybe lean in here and there, over time, where we see opportunity like Japan, opportunities in the US to grow more. But we want a fair bit of room to do that.

Keith Stegner

Okay, well, listen, everyone, thank you. And thank you, Scott, thank you JoAnn. It's been a pleasure. And, yes, thank you.

Scott Maw {BIO 18637895 <GO>}

Thanks, Keith.