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Starbucks' (SBUX) Management Presents at Morgan Stanley Global Consumer & Retail Brokers Conference (Transcript)

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Starbucks Corporation (NASDAQ:[SBUX](#))

Morgan Stanley Global Consumer & Retail Brokers Conference Call

November 18, 2015 08:00 ET

Executives

Scott Maw - Chief Financial Officer

Analysts

John Glass - Morgan Stanley

John Glass

Good morning, everyone. My name is John Glass, restaurant analyst at Morgan Stanley. Welcome to the second day of our consumer conference. It feels right to start the morning with coffee and so that's exactly what we are going to do this morning. Starting back in 1971 and then known as Starbucks Coffee, Tea and Spices, today, Starbucks has evolved into one of the largest, in my view, best run retailers of our time, my view and having had the experience of watching the company grow over the past 20 years, it has been a consistent element of this story where the company is continuing to reinvest in its business, in its people and standing clear to a mission of serving the best coffee and related items in the business.

2015 I think was a transformational year in many ways in the company's history, where the benefits of the reinvestments really showing up not just in the financial results, but in things like, evidence of things like the mobile platform, where I got this coffee this morning without waiting in line. I think no doubt that has the ability to drive the business to the next level.

It's my pleasure to welcome to the conference today, Scott Maw. Scott is the Chief Financial Officer of Starbucks. With that, welcome.

Scott Maw

Okay. Thanks, John. So, what I am going to do this morning is spend a few minutes taking a look at the financial performance of Starbucks, but what I really want to spend the bulk of our time this morning is reviewing our strategies for growth, because what I hope to sort of display is that the growth that we have had in the past is something that we intend to continue in the future. It's sustainable and it's really built off the backs of the strategies that we are using today and will continue to leverage as we move through time.

Forward-looking statement, it's important that you understand that we will be making forward-looking statements this morning. And let's just go ahead and take a quick look back on the financial performance of the company. So, over the last few years, you can see we have grown revenue at about 13% per year reaching over \$19 billion this year. If you adjust for foreign exchange that number round up to \$20 billion in 2015. We had a couple of points of headwind from foreign exchange like many companies with international operations were filling that a bit, but still sticking to our long-term growth targets despite that. We have 410 basis points of margin expansion over this period, 50 basis points in the most recent year. And I will just remind everyone that our acquisition of our remaining interest in Japan had a pretty significant impact on that operating margin expansion and so it will be much higher if you adjusted for that from '14 to '15. And then earnings grew quite strongly over this period, 21% on average on EPS on a non-GAAP basis, \$1.58 in the most recent year that was 19% growth over non-GAAP EPS the year before, and again, 2 full points of foreign exchange impact in that. So, pretty much every year, we were going at or above the top end of our range, so we feel pretty good about that performance as we look forward.

And I think perhaps most importantly is what's happened with our comps over the last few years. So, we have been at mid to upper single-digit comps every quarter for the last two years, '13 and '14, but you can see where transaction comps had sort of continuously trended down towards the end of last year. We ended last year with 5 points of total comp, 1 point of transaction comp and a pretty healthy ticket in there. There was a fair bit of premiumization in the tax driving that, but obviously, 1 point of transaction comp was something we wanted to improve.

And so as we headed into the holiday, we launched a number of initiatives and importantly, I am going to talk quite a bit this morning about the investments we have made in our people, our employees we call partners and investments we are making in the digital business that we really instigated in earnest in January of this calendar year. And those had a significant impact on our comps growth like we believe that they would. And you can see transaction comps turn nicely during our holiday quarter, which is Q1 in our fiscal, continuing to accelerate each and every quarter as we invested more, rolled out more innovation, did more things around the digital platform, reaching the peak in the most recent quarter of 8% globally with 4 points of transaction comp and 9 points of transaction comp in the U.S. Reminding you all that this is a great big store system that we are growing comps at 8%. It's no easy trick. And that's where the investments and all the things we have going from a strategy standpoint come into play and are so vital.

So, let's talk a little bit about those strategies. I think it's really important to remind you we are playing the long game. We are a \$20 billion company with an average ticket size of \$5. We are

growing the top line at 10% and the bottom line at, at least 15%. And if you are going to do that on our great big network, we are going to have to think strategically and frankly aggressively about the types of investments that we make and the types of things that we drive from an innovation standpoint. Our growth is built on innovation. It's built on the experience that our people provide in the stores. And if we don't invest, if we don't lean in there, then we are going to start to see softness on the top line. And so we are committed across all these strategies.

I will take you through each and every one, but I think the first one and perhaps the most important one is winning with our partner. So again, our employees we call them partners, because the vast majority of them are eligible to participate in a stock compensation program for Starbucks. And what this chart shows is the history of the investments, the history of total pay that we have had at Starbucks. We have always lead the industry in terms of total pay through things before 2015 like on-chip beverage, our partnership with Arizona State University, which in FY '14, was 2 years of college benefit, a competitive pay, stock composition that we call Bean Stock, which I talked about earlier and then healthcare for part-time workers well ahead of and deeper than what's available in the Affordable Care Act and we have had that for decades at Starbucks. So, leading in pay.

As we got into 2015, again, well ahead of and greater than the mandated minimum wage and pay changes and benefit changes that are coming down, we leaned in on how we pay our people. So that included compensation, that included adding a food benefit on shift, which was a great thing for our partners and also a great thing for us, because it reinforces what's becoming a growing part of Starbucks business. Food is growing faster than beverage in our U.S. stores and so providing a food benefit was a great way for us to introduce our partners to our food across broad day parts. And then we went to 4 years of college paid in '15. And for the first time, we really started to invest in what we call partner digital. So, all the things that we talked about around mobile and Mobile Order & Pay, that's been building for a while. But frankly, we fall on a little bit behind with partner facing digital.

So, I would argue our customer-facing digital and mobile apps are frankly industry leading. I don't think there is anyone out there doing it as well as we do. The technology that faces our partners I think we would fall on a little bit behind. So, we have in the last year we were leaned in on upgrading our POS system, basic things like improved laptops and printers in the store, handheld apps that allowed us to move from paper and pencil inventory system to a scanner based inventory system. And again, lot of this technology has been out there a while. We have just been a little bit slow to roll it out and so we are significantly accelerating that. And as we move into '16, even more on partner digital, so more things around apps for scheduling, a little bit more technology around how we determine schedules, the easier way for our partners to understand things that are going on in the store around buying routines, around our food and things like that. So, all of that will accelerate as we get into 2016. And then obviously, we will talk about the things we are doing on our digital platform from a customer-facing standpoint.

We also expanded college benefits to include spouses and children of our military partners and military spouses, again leaning in well ahead of mandated changes on pay and starting to do some things in the international markets. So, like the U.S., our total pay structure in the international market tends to lead the industry, but we want to do more in international markets,

markets such as China, the UK, we are introducing things like housing benefits that resonate with partners in those markets a little bit more than they do in the U.S. and so that's part of the dollars as we look at 2016. And so that adds up to just under \$150 million of incremental spend in the P&L in 2015, another \$100 million to \$125 million in 2016.

And I will just remind you, we can click back here that it's working and so the most important thing in all of this is as we have seen the success in the comps as we have seen our turnover actually tick down in an industry where everyone is seeing turnover actually tick up as the labor market improves. The difference between us and the industry average is now 18 full points on turnover. And so as these investments have driven higher returns, lower turnover and higher comps, we feel really confident that leaning in and investing is the right answer.

Okay. Moving onto the next part of our strategy, kind of three things and one here, I will talk a little bit about how we continue to lead the industry and premiumization of the coffee experience. I will talk about Teavana and how that's driving growth in our U.S. stores and how it will drive growth internationally as we move forward. And also, we will talk a little bit about the occasions and expanding day parts. So the first one is coffee leadership and I think the place to start here is around all the things we are doing with Starbucks Reserve coffee and how we are innovating on that front. Just as an example, we have 1,500 stores that have Clover that you can see in the upper right hand corner there, Clover machine, which is a fantastic way to enjoy a cup of coffee. And that's up 50% from where we were just a year ago. So we continue to see response from our customers, drive transactions, drive profitability by putting more Clover machines in, more Starbucks Reserve in more stores. And by the way, we see lots of opportunity in that internationally. So the numbers I quoted there were just be the U.S. market. But when we look at China and Japan and the UK, we also see significant traction around rolling out the Reserve brand.

In China, more and more of our stores have Reserve. More and more of our stores have a Pour Over bar where you can interact more with the barista and understand and learn more about the coffee. And just as a reminder to everyone, we still are the premium – the premier brand in sourcing, roasting and delivering the finest coffees in the world. And probably the pinnacle of that experience is our Starbucks Roastery in Seattle. So this is the store, I think many of you have been to, it's several times larger than our normal store. It has roasting capability onsite, so it's a mini roasting plant. We are able to take small batch, very unique coffees and roast them in that Roastery and ship them around the world to sell under the Reserve brand. There are several different ways to enjoy coffee, you can do a Pour Over, Clover, there is swiping machines, lots of different ways to learn about coffee. And then as we move forward, we will take elements of that Roastery experience and take it into – up to 500 Starbucks Reserve stores. So these will be larger format stores that have elements of that Roastery in it, have a lot of ways to interact with the barista, get to understand coffee, we will be all focused around that Star R brand, Starbucks Reserve and we will continue to deliver significantly up leveled coffee experience to our customers.

And then just to touch briefly on agronomy, so over 99.5% of our coffee is ethically sourced. We have seven Farmer Support Centers in different geographies around the world in coffee origin companies. Those support centers have dedicated Starbucks agronomists that ensure that not

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