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Starbucks Corp. (SBUX)

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MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon, my name is Rob, and I will be your conference operator today. At this time, I would like to welcome everyone to Starbucks Coffee Company's Fourth Quarter and Fiscal Year 2017 Earnings Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. [Operator Instructions]

We'll now turn the call over to Tom Shaw, Vice President of Investor Relations. Mr. Shaw, you may now begin your conference.

Tom Shaw

Vice President-Investor Relations, Starbucks Corp.

Good afternoon, everyone, and thanks for joining us today to discuss our fourth quarter and full year results for fiscal 2017. Today's discussion will be led by Kevin Johnson, President and CEO; and Scott Maw, CFO. For Q&A, we'll be joined by Roz Brewer, Group President Americas and Chief Operating Officer; John Culver, Group President, International and Channels; Matt Ryan, Global Chief Strategy Officer; and dialing in from New York, Howard Schultz, Executive Chairman.

This conference call will include forward-looking statements which are subject to various risks and uncertainties that could cause our actual results to differ materially from these statements. Any such statements should be considered in conjunction with cautionary statements in our earnings release and risk factors discussions in our filings with the SEC, including our last Annual Report on Form 10-K. Starbucks assumes no obligation to update any of these forward-looking statements or information.

Before handing the call over to Kevin, I'll take a moment to clarify that all references on today's call will be on a non-GAAP basis. GAAP results in fiscal 2017 includes several items related to strategic actions the company is taking as it focuses on accelerating growth in high-returning businesses and streamlining its operations. These items include restructuring and impairment charges, transaction and integration costs, gains related to changes in ownership of international markets, and other items. These items are excluded from our non-GAAP results.

Additionally, please note that fiscal 2016 contained an extra week in the fourth quarter, which resulted in incremental revenue and income for both Q4 of fiscal 2016 and full year fiscal 2016. Our comparisons to fiscal 2016 results exclude the effect of this extra week. Please refer to our website at investor.starbucks.com to find the reconciliation of non-GAAP financial measures referenced in today's call with our corresponding GAAP measures. This conference call is being webcast and an archive of the webcast will be available on our website as well.

I will now turn the call over to Kevin.

Kevin Johnson

President and Chief Executive Officer, Starbucks Corp.

Well, thank you, Tom, and welcome, everyone. Today, Starbucks Coffee Company reported another quarter and year of strong performance, with each of our business segments around the world contributing to record results. On today's call, I will provide highlights of Q4 and fiscal 2017, and share our view of Starbucks' longer term growth opportunity. Scott will then take you through details of our operating and financial performance and updated guidance.

In fiscal 2017, Starbucks delivered record revenues of $22.4 billion, a record 19.7% non-GAAP operating income margin, and non-GAAP earnings per share growth of 11% over prior year. At the same time, we made significant investments to support the growth of our business and added over 2,200 net new stores, to a total of now over 27,000 stores globally.

China was a stand out in fiscal 2017, posting 7% comp growth, strong revenue growth, and another year of record AUVs and strong profitability. We added over 550 net new stores in China in fiscal 2017 and now have nearly 3,000 stores in 135 cities. We capped fiscal 2017 with a solid Q4, delivering 3% comp growth in the Americas, and 3% globally, and in the U.S., after adjusting for nearly one point of impact from Hurricanes Harvey and Irma. Millions of people, hundreds of communities and thousands of our Starbucks partners were impacted or displaced by devastating storms in Q4. Over 1,100 Starbucks stores were closed for extended periods. But the hurricane story is a human story, and I'm proud and appreciative of how our Starbucks partners responded to our customers and communities in distress.

Starbucks posted record, in many cases industry-leading, financial and operating results in both fiscal 2016 and 2017, but a balanced conversation of our performance over the past two years acknowledges that we have not consistently delivered against our long-term financial targets, prompting a review to ensure that our targets are aligned with our strategic plan and the current operating environment. By way of background, we last revised our long-term targets in 2010, and we are very proud of our performance since then, more than doubling revenues, tripling earnings, quadrupling market cap, and increasing store count by over 10,000 locations globally.

Our strategic planning process serves as the basis of our long-term financial outlook and is informed by three guiding principles. First, Starbucks is committed to remaining a growth company and delivering well above industry average comp, revenue, and profit growth. Second, Starbucks is committed to streamlining our business, sharpening our focus, and making thoughtful investments that position us to play the long game. And third, Starbucks is committed to a value creation strategy that includes both consistent, long-term profitable growth and rewards shareholders by returning cash in the form of dividend increases and share buybacks. With those principles in sharp focus, we challenged ourselves to balance the growth opportunity ahead with the headwinds confronting all retailers, particularly brick-and-mortar and restaurant retailers.

Our results over the past two years and the need to continue investing for growth, taking each of these factors into consideration, today, we introduced new long-term financial targets. Comp growth of 3% to 5%, revenue growth in the high single digits, and EPS growth of 12% or better. Now Scott will provide additional details, but we believe that these new targets represent performance that we can meet or beat in the years ahead, while continuing to deliver best in class growth for a global business of our scope and scale.

We are driving three important actions in support of our long-term guidance. First, we are committed to investing in our future, specifically as it relates to partners, food and beverage innovation, digital innovation and Starbucks Reserve. Second, we are adapting our cost structure to align with this new long-term guidance with focus on G&A and the middle of the P&L. Third, we are streamlining our business and directing our investments toward businesses and operations where our growth prospects and returns are the greatest, while transitioning, whether by licensing, divestiture, or otherwise, businesses and operations where returns and long-term growth prospects are less attractive.

Examples of recent streamlining activity include almost doubling our company-owned operations in Mainland China, through the pending purchase of the remaining 50% of our East China operations, moving our businesses in Singapore, Germany, and Taiwan, approximately 700 stores in aggregate to a 100% licensed market model, initiating the closure of all Teavana retail stores, selling TAZO in order to focus on Teavana as our premium tea brand and eliminating our Starbucks e-commerce operation in order to better leverage our channel partners. Starbucks future returns will increasingly benefit from our ongoing initiatives to further streamline our business.

In addition to our streamlining activities, we remain focused on executing against our six operational priorities. Progress against our priorities form the foundation and will be the proof points of our new guidance. And in Q4, we made significant progress against each priority. Scott will walk you through the details, but here are a few highlights. Let me start with our efforts to accelerate U.S. comp. Increased customer adoption of Mobile Order & Pay has resulted in a sustained increase in demand, particularly in our highest volume stores at peak.

We continue to leverage lean principles to further improve our in-store production engine, further increase throughput and deliver an improved customer experience. This work, combined with labor deployment, digital order management and channel focused production have enabled us to unlock capacity, particularly in our busiest mobile order stores at peak. In fact, transaction comp in the U.S., net of hurricane related impact, was the strongest performance in six quarters. At the same time, customer experience scores for both Mobile Order & Pay and non- Mobile Order & Pay customers reached record levels in Q4.

Our next operational priority is driving innovation in food and beverage, and naturally links to our efforts to accelerate U.S. comp. Innovation across our coffee and tea beverage platforms, with emphasis on cold, including our Cold Brew platform, Iced Espresso beverages, and Teavana Infusion Shaken Iced Teas, all contributed to our growth in Q4. In addition, we are leaning into our fast growing categories around Cold Brew, Draft Nitro beverages, and plant-based modifiers, including almond, coconut, and soy milk alternatives. Not only are these fast growing platforms highly relevant to our customers, our research demonstrates that they also provide a significant opportunity to drive food attach outside of our core morning daypart. Our food program continues to grow and expand with food mix now over 21% for the first time ever in Q4, giving us confidence that we will reach our target of 25% food mix by 2021.

Our priority to accelerate the power and momentum of our digital flywheel reflects the fact that digital relationships are among our most powerful demand generation levers. In fiscal 2017, Starbucks Rewards membership in the U.S. rose 11% year-over-year. Per member spend increased 8% in Q4 alone. The cumulative effect is that today 36% of tender comes from Starbucks Rewards, the vast majority, via our mobile app. Having made measurable progress increasing throughput and customer experience at peak, we can soon begin offering Mobile Order & Pay capabilities and features to all customers, Starbucks Rewards member or not. In quarters ahead, all customers will be able to download our app, set up a digital relationship with Starbucks, select a payment vehicle of their choice, and use Mobile Order & Pay. This is the first of many initiatives that will combine direct digital relationships with new value propositions in order to expand the total universe of customers with whom we engage and communicate.

The digital flywheel platform continues to evolve with new features and support new geographies. We recently launched Starbucks Rewards in Japan on the digital flywheel platform and already have nearly 2 million members, well ahead of our most optimistic projections, with stored value as a percent of tender doubling in just a few short weeks. Japan also represents the first instance of our new global cloud based customer digital technology platform that will enable new capabilities and features in markets around the world, including North America. The platform launched with near perfect performance.

The next major application of this new technology platform will enable the launch of financial services products in the U.S. in conjunction with Chase. We are pleased to announce that our first product with Chase to be launched this winter will be a co-branded Visa credit card, enabling customers to receive Starbucks Rewards with their purchases both in and out of Starbucks stores. The second product, the prepaid Visa card we have discussed on prior earnings calls will be introduced shortly thereafter. Both products will afford options, a very rich rewards proposition for people who spend on credit, and the unique stored-value product offering rewards for customers who prefer debit.

Our fourth operational priority is enabling long-term growth in China. Our China growth strategy will be amplified as we transition our East China JV to a company-operated market and begin leveraging our local leadership teams and economies of scale to maximize the growth and profit opportunity ahead. The opening of the Shanghai Roastery next month will further elevate the Starbucks brand in China, while at the same time adding to our momentum across the business and market, underscoring, once again the significant growth opportunity that China represents for Starbucks.

Our fifth operational initiative is elevating the Starbucks Experience through Roasteries and Reserve. Since 1971, the Starbucks brand has been built through leadership around all things coffee and tea. And through the consistent delivery of a premium retail customer experience, the Starbucks Experience, our Starbucks Roasteries and our Starbucks Reserve brand built on that long heritage and are central to our innovation strategy around branded, experiential retail customer destinations. Our Starbucks Roastery continues to attract and delight local customers and visitors from around the world, while delivering double-digit comp growth and an average ticket approaching four times that of a typical Starbucks store. And our Seattle Roastery will further benefit when our first Princi store opens inside it next week.

We have great plans for the high-end artisanal Italian bakery, Princi. Princi will be embedded in every Starbucks Reserve Roastery, including our extraordinary 30,000 square foot Shanghai Roastery opening next month, further elevating the culinary experience we offer customers. We also plan to add a number of stand-alone Princi stores, featuring Starbucks Reserve coffees in the years ahead. Our Roasteries and Reserve brand continue Starbucks tradition of delivering premium quality and groundbreaking innovation. And both reaffirm our coffee and tea leadership, and create further separation from the industry with Roasteries in New York, Tokyo, Milan, and Chicago under construction or development, fiscal 2018 will be a year of significant investment. I invite you to join us on December 6 for opening day of our Shanghai Roastery.

Our sixth operational priority is gaining share of at-home coffee. Scott will take you through the details in a moment, but let me just say that we continue to innovate and win channel share in premium coffee, recording a very strong quarter of 8% revenue growth.

As you can see, we remain laser focused on successful execution against our six operational priorities. The Starbucks has always sought to be a different kind of company, a company that consistently delivers industry-leading financial performance, while at the same time, using our scale for good. In addition to delivering record results in fiscal 2017 against a difficult industry backdrop, we are proud of the many important social impact initiatives we advanced, all of which support our brand.

We have created opportunities for many. In the past year alone, we hired more than 40,000 Opportunity Youth and aspire to hire 100,000 by 2020. Earlier this year, we surpassed our goal of hiring 10,000 veterans and military spouses, and have now increased our goal to hiring 25,000 by 2025. In addition, we now have over 8,000 Starbucks partners enrolled in the Starbucks College Achievement Plan in partnership with ASU. I'm particularly proud of how our partners responded to the powerful hurricanes that devastated South Texas, Florida and Puerto Rico. They responded with resilience, compassion, strength and unity, supporting their partners, customers, and communities.

Before handing the call over to Scott, I'd like to take a moment to acknowledge our Starbucks leadership team, a talented, experienced, committed and diverse group of servant leaders. We are a team committed to Starbucks future, and I'm honored to officially introduce Roz Brewer, our newly appointed Group President, Americas and Chief Operating Officer. With John Culver as Group President, International and Channels; Cliff Burrows, as Group President, Siren Retail; and Roz in her new role, we have three very strong and seasoned operators leading these businesses. Our entire leadership team is aligned around the strategies I have outlined for you today, and I have the utmost confidence in our future.

With that, I'd like to hand the call over to Scott. Scott?

Scott Maw

Executive Vice President and Chief Financial Officer, Starbucks Corp.

Thank you, Kevin, and good afternoon, everyone. As Kevin shared, fiscal 2017 was another year of strong performance for Starbucks. We reported solid top and bottom-line growth and in Q4, our best increase in U.S. traffic since early calendar 2016, despite a challenging retail operating environment overall. On today's call, I will provide an overview of our Q4 and 2017 results, expand on Kevin's comments regarding our long-term financial targets, and introduce guidance for fiscal 2018.

Q4 non-GAAP EPS of $0.55 was up 10% over last year, and includes a $0.01 benefit from higher income on unredeemed Starbucks cards, offset by an estimated $0.01 of negative impact resulting from the hurricanes, primarily from lost sales. Our Q4 non-GAAP operating margin came in at 20%, down 90 basis points from last year, the result of a 130-basis-point increase in partner and digital investments, 70 basis points from mix shift, principally increased food sales in the U.S., and an estimated 40 basis points of hurricane-related impact, partially offset by strong sales leverage, particularly in CAP.

I'll now take you through our Q4 operating performance by segment. Americas revenues grew 7% in Q4 to nearly $4 billion, primarily driven by 952 net new store openings over the past 12 months, and 3% comp growth. Americas 23% Q4 non-GAAP operating margin was down 390 basis points from last year, the result of 180 basis points of incremental U.S. store partner investment, 90 basis points from food sales driven mix shift, and 40 basis points attributable to the hurricanes. For the year, Americas grew revenues by 8%, and delivered an operating margin of 23.4% compared to 25% in 2016, primarily due to increased partner investments.

In Q4, our core espresso, tea, and refreshment beverage platforms delivered a combined 2 points of U.S. comp growth, partially offset by blended Frappuccino beverages, primarily in the afternoon daypart. Food also contributed 2 points of comp, now for the third consecutive quarter, driven principally by increased attach. Mercato continues to perform very well in both Seattle and Chicago, with a fresh food focus that is driving customer delight and incrementality. Also, disciplined price adjustments continued to help us offset rising labor and other input costs. As holiday approaches, we have a full pipeline of innovative food and beverage offerings, and returning seasonal favorites to surprise and delight our customers, and we're fully prepared for increased holiday traffic in our stores, with the throughput initiatives Kevin discussed, positioning us to continue delivering improved transaction comps at peak.

Moving on to China/Asia-Pacific, CAP once again delivered company-leading growth in Q4, with revenues increasing to $860 million, up 14% after adjusting for 4 points of FX. CAP's growth was largely driven by the over 1,000 net new stores opened during the past 12 months, and 2% comp growth. China continued its outperformance with 8% comp growth, its strongest in nine quarters, driven by food and core beverage performance, momentum in Starbucks Rewards, and increasing sales of Teavana branded handcrafted tea beverages. Teavana has now contributed 2 points or more to China comp every quarter since we introduced the brand into the China market last year.

Comp growth in Japan improved sequentially from Q3, overall store and market profitability in Japan remain very strong, with comp growth in core food, tea, and espresso categories offset by negative comp in blended. For perspective, sales of blended beverages in Japan, represented over 40% of sales mix in the spring and summer months, compared to less than 15% in the U.S. Thus, shifts in blended sales in Japan have a disproportionate impact on both Japan and CAP comps overall. For that reason, it is important not to over index on Japan comps as we shift away from blended towards a broader mix of core products.

CAP operating income increased 16% to $219 million in Q4, while operating margin expanded 140 basis points driven by strong performance from both our company-owned stores in China, and our JV partnerships in East China and South Korea. South Korea, now our fifth largest global market, with system sales exceeding $1 billion, deserves special mention, boasting double-digit comp growth in fiscal 2017, and further underscoring the broad success we are having across CAP. For the year, CAP revenues grew 14%, excluding two points of negative FX and operating income a stunning 24%, driven by strong operating performance across the segment, and the benefit of value-added tax changes in China.

I'd like to take a moment to highlight the significant profit growth engine we have built in CAP, where together, our CAP markets delivered nearly 50% of total Starbucks' total non-GAAP operating income growth in 2017. We see another year of strong operating income growth in 2018, with CAP once again contributing a material portion of our absolute growth. And the acquisition of our East China business will be further accretive to our CAP growth rate, particularly as we move through this year and into 2019. Starbucks now has two significant profit engines driving our global returns, our North America business and the broader CAP market. Going forward, we'll be allocating more time to CAP in our prepared remarks, given the increasing importance of the segment.

Turning to EMEA, in Q4, EMEA delivered revenue growth of 7% to $270 million, the segment's strongest quarterly revenue growth in three years. Company operated store comp was 1% in the quarter while system-wide comps increased a strong 5%. EMEA margin in Q4 was 12.9% compared to 16.2% last year, reflecting softer performance in our company-owned markets and a 210-basis-point impact from a tax settlement in Q4 2017, offset by the benefit of store mix shift towards the licensed model. For the year, EMEA revenue declined 8% relative to 2016. However, adjusting for FX and the impact of mix shift to licensed stores, EMEA revenue grew 7%, a strong result given the challenging economic and geopolitical backdrop.

Non-GAAP operating margin of 13.2% was roughly flat to 2016 that included 140 basis points of negative FX impact. Today, of EMEA's nearly 3,000 stores, 83% are licensed. Our continued focus on improving operations and shifting the mix to more licensed stores has resulted in consistent mid-single digit system-wide comp growth in EMEA and 13 consecutive quarters of double-digit operating margin.

In Q4, our Channel Development segment grew revenues by 8% to $515 million, and operating income by 7% to $247 million. We gained share in both K-Cup and roasting ground categories, and increased our share of total coffee by twice the category growth overall, performance that is particularly noteworthy given increased composition and discounting in the face of slowing category growth. Growing Teavana in CPG channels is a major opportunity for us. In our pilot markets, Teavana ready to drink tea, captured the leading position in the super premium tea category during the quarter, and given the enthusiastic response to-date, we have accelerated our national rollout to this coming January. We also remain on track to launch Teavana-based packaged teas in grocery channels by the end of fiscal 2018.

Channel Development operating margin was roughly flat at 47.9%, the net of improved sales leverage offset by promotional activities. For the year, Channel's revenues exceeded $2 billion for the first time ever, up 6% year-over-year, increasing to 8% year-over-year after adjusting for the two-point impact of revenue adjustments in Q2. Starbucks' total coffee share grew by one point compared to an essentially flat market, and our dollar share expanded by over 5%. Operating income grew 13% and margin expanded by 260 basis points driven by COGS, including coffee favorability, strong performance from our North American Coffee Partnership and sales leverage.

Let's now shift to our consolidated full fiscal year 2017 results. For the full fiscal year 2017, Starbucks posted consolidated revenue of $22.4 billion, representing 7% growth year-over-year, driven by new stores and 3% comp growth. Non-GAAP operating income increased by 8% to $4.4 billion, and operating margin increased by 10 basis points to 19.7%, as strong sales leverage was offset by 110 basis points of increased partner investments. Growth rates in both operating income and non-GAAP EPS were impacted by one point of negative FX. In addition, investments in Reserve Roastery and Princi brands, operations that we collectively refer to as Siren Retail, were up significantly from 2016, and higher than we expected at the outset of 2017 as we shared during our Q3 call. We expect the impact of these investments to increase at a similar rate in fiscal 2018, and at a reduced rate as we move into fiscal 2019. Finally, we returned a record $3.5 billion to shareholders in fiscal 2017 through dividends and share repurchases.

Let's now spend a few minutes on our revised long-term guidance. Going forward, we see revenue growth in the high single digits, and comp growth in the 3% to 5% range, performance that should enable us to deliver non-GAAP EPS growth of 12% or greater, and ROIC of 25% or greater. As discussed at Investor Day, we see ongoing opportunities in COGS savings and core G&A growing at half the rate of revenue growth. This change in our growth targets requires us to look at all financial aspects of our business including capital return to shareholders. For perspective, in the three years ending in 2014, we returned $3.8 billion in capital to shareholders, a figure that more than doubled to $9.1 billion in the three fiscal years ending in 2017, as prudent leveraging of our balance sheet, combined with strong operating performance enabled us to significantly increase dividends and share repurchases.

Dividends over the six-year period increased an average of 24% annually and our earnings payout ratio is now nearly 50%. Today, we announced another 20% increase in our quarterly cash dividend to $0.30 per share, and we also announced a new commitment to returning $15 billion to shareholders through dividends and share repurchases over the next three years. As part of this action, we will increase our leverage to support debt ratings that are one notch lower than our current rating agency results. This reflects our confidence in the strength of the business and our commitment to increasing cash return to shareholders.

Let's now turn our attention to our financial targets for fiscal 2018. We expect global comp growth in fiscal 2018 to be in the 3% to 5% range. Complementing this comp growth will be the addition of approximately 2,300 net new (sic)[Starbucks] stores globally. Our China/Asia-Pacific segment will drive roughly half of our global store growth in fiscal 2018, with 1,100 net new stores, nearly 600 in China. Our Americas segment plans to add 900 net new stores, split roughly evenly between company owned and licensed, and EMEA is targeting approximately 300 net new stores, virtually all licensed. While on the topic of store growth, I'd like to take a moment to specifically address questions concerning whether our U.S. sales are simply being transferred from existing stores to new stores as we grow our U.S. store portfolio.

And let me be clear, the effect of sales transfer on our U.S. store comp is small and stable, and the overall effect of new stores on comp and profit growth remains very positive. Net new store portfolio growth rates in the U.S. have been roughly 5% for the past few years and company-owned portfolio growth rates have been even lower at 4%. Our new store formats, including a strong mix of drive-through locations, improved real estate analytics, and the ability to use new stores to drive improved throughput in existing stores are all important factors in keeping the net impact on our financial returns from new stores in the U.S. a strong positive. The topic of new store sales transfer remains a non-issue for Starbucks.

It is important to note that our effects to streamline our business will have an impact on reported 2018 revenue growth. Specifically revenue will be impacted by the recent shifts in our retail store portfolio, including the pending acquisition of East China, and licensing of Taiwan and Singapore, and the strategic actions we are taking to exit our non-core activities including closing Teavana stores and the Starbucks e-commerce platform, selling TAZO and aggressively rationalizing merchandise available for sale in our U.S. retail sales. We estimate these changes will add two to three points to targeted revenue growth in the high single digits.

As it relates to GAAP EPS, the impact of these actions will be very positive given the large expected gains on East China and on TAZO. For non-GAAP EPS, the net impact will be relatively modest in 2018, flat to slightly accretive as the benefit from closing the Teavana mall stores and adding the East China business are offset by the Taiwan, TAZO, and Singapore transactions. Again, the cumulative impact of these moves will begin to become more meaningfully accretive to earnings growth as we move into the back half of fiscal 2018, and into 2019.

As a reminder, we will hold a detailed modeling call in January to take you through the specific impacts of the East China acquisition on CAP and total company results. Also we recognize that the cumulative effect of the strategic transaction and activities will have a meaningful impact on reported results, and we'll be sure you have a full reconciliation and a clear view on core revenue and earnings growth rates as we move through 2018.

Finally, it's important to note that the both the East China and TAZO transactions require regulatory approval prior to closing. Fiscal 2018 consolidated operating margin is expected to be up slightly relative to fiscal 2017, excluding the impact that the change in ownership structure in East China has on operating margin. We expect leverage on cost of goods sold as we continue to make progress against our savings target through 2021. We will grow core G&A at half of the rate of revenue growth, a goal we met in 2017 after adjusting both 2016 and 2017 for items affecting comparability. Notably, the incremental dollar impact from partner and digital investments is expected to be lower in 2018.

Looking at our segments, we expect our operating margin in the Americas to be up slightly relative to 2017, reflecting sales leverage, optimized labor deployment, and COGS and waste efficiencies. We expect moderate margin expansion from our CAP segment in 2018, excluding the impact from the change in the ownership structure for East China, driven by strong operating results throughout the region. We expect solid margin expansion from our EMEA segment in fiscal 2018. Channel Development will continue to grow share and deliver best in class performance in fiscal 2018 with slight margin expansion over the prior year.

As mentioned earlier, a significant portion of the 2017 favorability in channels was driven by commodities and COGS favorability that we don't see continuing at the same levels in 2018. Also we expect to see margin improvement from our NACP partnership, but again, at lower levels than 2017. With competitive pressures on the rise, we remain laser focused on driving profitable share growth as we head into calendar 2018.

Neither FX nor commodities are expected to have a major impact on year-over-year profit growth, and our coffee needs are roughly 75% price locked for fiscal 2018. We expect our effective tax rate for 2018 to be approximately 27%, including approximately 6 points of favorable impact from the planned acquisition of East China.

Capital expenditures in fiscal 2018 are expected to total roughly $2 billion, up from $1.5 billion in 2017. The increase is split evenly among investments in Siren Retail, store related capital, and our supply chain and corporate facilities. This last category includes the addition of roasting capacity to handle increased demand globally for Starbucks coffee.

Our GAAP EPS growth rate in fiscal 2018 is likely to be above 40%, given the large gains likely contributing over $0.50 of incremental EPS we expect from the East China and TAZO transactions. Given these inputs, we expect non-GAAP EPS growth of 12% to 13%, or $2.30 to $2.33 per share in fiscal 2018 with growth in the front half of the year, likely a bit below the full-year average, and growth in the back half somewhat above it. Three factors will drive this improved profitability over the course of 2018: The timing impact of the strategic actions we discussed earlier, with the impact increasing as we move into the back half of the year, operational savings in the U.S. business will ramp up over the course of the year, and buybacks will be more accretive to EPS each quarter in 2018.

As we entered fiscal 2017, the company was shaped to support a 5% or greater comp profile. Our investments, G&A expense and overall shape in the middle of the P&L required that level of growth to deliver on our 2017 commitments. Going forward we will complement our laser focus on delivering profitable growth with a renewed focus on driving operational efficiency, and to streamlining and reshaping the company in order to deliver or exceed the new financial targets we introduced today, while funding our investments, increasing our operating margins, driving further returns on invested capital and providing outsized returns to our shareholders. As always, credit for our ability to deliver another year and quarter of record performance belongs to our store partners who proudly wear the green apron, and deliver an elevated Starbucks experience to our customers all around the world every day.

With that, I'll turn the call back to the operator. Operator?

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from the line of John Ivankoe, JPMorgan.

John William Ivankoe
Analyst, JPMorgan Securities LLC

Q

Hi, thank you, obviously a lot to get through on this call, but I'll limit my question to the cost side of the equation. Kevin, in your prepared marks, it seemed like you were opening the door to what may actually be a significant kind of rethink or redo from the cost structure of the business. I think you mentioned both G&A in the middle of the P&L, but in Scott's remarks we're still talking about G&A growing at half the amount of revenue, and at least I didn't pick up anything discrete that was happening at the store level from a cost perspective. So I just wanted to kind of juxtapose those two different themes of conversation, because I heard different things, and to the extent that revenue isn't quite what we want, how much of an opportunity is there at the store-level P&L and G&A relative to the initial guidance that you've given for fiscal 2018? Thanks.

Scott Maw
Executive Vice President and Chief Financial Officer, Starbucks Corp.

A

Thanks, John, I'll start and then I'll turn it over to John Culver. The first thing I would say is in the core G&A of the business, there is still significant opportunity to drive leverage. We have a target of growing core G&A at half the rate of leverage, but that's – or half the rate of revenue, but that's just the target. We will try to beat that. And what's important as we move through these streamlining opportunities, selling TAZO, licensing more markets, we'll be able to lean in on corporate and business unit G&A further because the simplified operations give us that opportunity. And then what is a little bit new this time, and where we're really digging in, is really around labor and waste in particular in the U.S. business, and there's significant opportunity there, and I think we should give you some specifics on that. And I'll have John do that.

John Culver
Group President-Starbucks Global Retail, Starbucks Corp.

A

Yeah, John, just real quick, clearly the biggest driver of the growth is going to be transaction growth, and how do we continue to accelerate transactions, both in terms of driving more product innovation in the stores, driving more throughput through our existing stores, and then continuing to enhance these digital relationships. That will allow us to drive leverage into the P&L. Last quarter was our best growth quarter in terms of transactions in six quarters. So we're starting to get traction there.

Secondly, this work around labor and deployment is critical. We're doing a lot of work around how we're deploying labor in our stores, looking at both ends in terms of where we want to invest to drive more throughput and productivity, as well as where we need to pull back if we need to.

We are looking at this through the lens of what labor investments are going to be revenue and margin accretive, and really, given the work that Matt and his team have done with the analytics they now provide us on a per-store basis, we're able to go in and look at it on a per-store basis and a much more detailed view in terms of sales mix, in terms of the channels that are operating in those stores, and then also just the overall format of the store.

And then the other piece that we're looking at and doing a lot of work on, beyond the labor and deployment, is around COGS and the COGS savings. And last, at the analyst conference, we made a big commitment in terms of COGS savings over the course of now, between 20 and 21, and we're committed to delivering those savings, and we're on track to do so. That will continue to drive more leverage in the P&L.

And then the last piece is around waste in the stores, and how do we manage more effectively waste, and then while at the same time increasing overall availability of our products in our stores, so that we can sell more product. So that's another big piece.

And then this last area, I would just say is around, how do we continue to rationalize SKUs, and look at the number of SKUs that we have in our stores. We feel that this is an area of big opportunity for us, and creates a big unlock for our stores and our partners, and this falls into the work that we're doing around the streamline activity in the stores.

Operator: Your next question comes from the line of Sharon Zackfia from William Blair.

Sharon Zackfia
Analyst, William Blair & Co. LLC

Q

Hi, good afternoon. Hi. I guess a question on kind of the algorithm going forward, Scott. So I appreciate the guidance specifically for 2018. I guess longer term with that comp range being 3% to 5%, could you give us an idea of what that 5% would equate to for earnings growth? And I'm assuming all of these investments or things that are going on in 2018 make that relationship not hold, and if I'm wrong, if you could correct me?

Scott Maw
Executive Vice President and Chief Financial Officer, Starbucks Corp.

A

Yeah, thanks, Sharon, what I would say is, as we exit 2018, we'll be growing earnings per share higher than the range that we gave for 2018. So we gave 12% to 13%, we'll have accelerating profitability, as we move throughout the year and there's two big drivers of that. The first is the things that John talks about around store operations, that will layer in over time.

And the second big driver is all the things that we're doing around project streamline, what we call project streamline, the streamlining and focus of the operations. The big increment in those activities is around East China, and the exit of our Teavana stores, which as you know are a drag on earnings, and so all of that will help shape our profile.

To get to your specific question, and the way I think about the upper end of the EPS algorithm, if you want to call it that, is if you look at what we did with revenue guidance and comp guidance, as we brought it down a bit, and we brought the lower end of our EPS guidance down to 12%. Our old guidance was 15% to 20%. I would say a similar move down at the high end is probably the way to think about the upper end of that guidance. So as we accelerate all the savings we'll get through streamlining our operations, we bring in East China, and if we get additional comp growth, then that would be upside even to the guidance we gave this year.

Operator: Your next question comes from David Tarantino, Robert W. Baird.

David E. Tarantino
Analyst, Robert W. Baird & Co., Inc.

Q

Hi, good afternoon. My question is on the comp trends, and first, just a clarification. The check trends or the ticket contribution this quarter was less than what it has been in the past, so could you talk about the factors that drove that, I guess smaller benefit from the ticket. And then secondly, as you think about the outlook for this year, in the

3% to 5% range you provided, I guess what are the factors that are giving you the most confidence in being able to guide that way, given the most recent quarter was at the low end of that?

Scott Maw
Executive Vice President and Chief Financial Officer, Starbucks Corp.
A

Okay. David, I'll start and then I'll hand it over to Kevin for the second part. So some of the mechanics on ticket, it's important to remember that the order consolidation impact of the change that we had in the Starbucks Reward program has two equal and offsetting impacts you'll recall. It brought transactions down, but it also brought ticket up, as the sort of incentive to split orders went away. And so transactions, as you know, have been depressed over the last five quarters because of that and ticket has been higher over the last five quarters because of that, and this is the first quarter that we fully lap that impact. So that's the first thing.

The second thing is, we've had for the last few years one point to two points of pricing that we've taken pretty much every quarter. We were on the lower end of that range this quarter. That's pretty much related to timing. There's nothing that we're signaling there. Our pricing moves are still taking hold the way that we expect, and we'll continue to lean in where we see opportunities there.

And then the third thing that we talked about a little bit in the prepared remarks is the afternoon day-part, and what's important to understand about the afternoon day-part is it does have a higher ticket. You get more attach, more multiple beverage ticket, and obviously Frappuccino has a little bit higher ticket.

So those are the three big pieces.

Kevin Johnson
President and Chief Executive Officer, Starbucks Corp.
A

Yeah, David, this is Kevin. I would just add what gives us confidence in terms of that guide for the 3% to 5% comp in FY18, I think, first of all, as we look at data and have analyzed the overall U.S. retail restaurant industry, certainly that has shown very flat comparables – even a little bit negative traffic, and we've consistently outperformed that. Over the last two years, we have consistently sort of been in that range of 3% to 5%. But then I would just comment, as we go into Q1, we have a very solid holiday plan in place, and the start to this quarter gives me added confidence that the guidance we've given you for FY18 is not only achievable, but we feel like we've got line of sight to what we've got to execute against and we're executing against the right priorities and see evidence in every one of those areas that our work is paying off.

Operator: Your next question comes from John Glass, Morgan Stanley.

John Glass
Analyst, Morgan Stanley & Co. LLC
Q

Thanks very much. Regarding the investments you are making – you have made over time. We've talked about investment, but it has never been clear. Are these just required increases in compensation, for example at the partner level, how much of this is sort of related to growth? So Scott, can you just talk about what that investment, however you want to break it down, was in 2017 and maybe how you can relate that to what the incremental is going to be in 2018? Just so we can sort of frame that. And I think you talked about your cost structure is built historically on a 5% comp, and obviously that made this year more challenging. What comp did you build your cost structure off of in 2018? Thanks.

Scott Maw
Executive Vice President and Chief Financial Officer, Starbucks Corp.

A

It's a good question. Thanks, John. So the first part of the question, what I would say is, you'll recall we have $250 million of partner and digital investments in 2017. That's right where we landed. The biggest portion of that was related to partner investments, and the biggest portion of that is wage, but the vast majority of that wage investment we're making is not mandated. It's not minimum-wage driven or mandated by cities or states. It's really what we're trying to do to make sure we're investing in our partners in the right way. And as you know, we have turnover rates that are significantly below everyone else in the industry. We have seen turnover in the last year come down across every category within our stores. So we know when we get that part right. We see customer service scores at the highest they have ever been. Partner experience scores at the highest that we would – that they've ever been. So we know when we get that right, it pays off for us. So the biggest piece is voluntary wage investments, and that will continue.

As we roll into 2018, what I will tell you is there will be a little bit lower dollar amount investment in wage. It's still significant, but it's a little bit lower, so there's a bit more flow through in the U.S. P&L as a result of a little bit lower wage investment.

And then to your specific question, we built that 12% to 13% EPS growth assuming the lower end of the range, and so we should be able to deliver that at a 3%-plus comp, and that's the way we wanted to be shaped, and the goal is obviously, with all of the things that Kevin talked about on the topline is to try to beat that.

Operator: Your next question comes from Jeffrey Bernstein from Barclays.

Jeffrey Bernstein
Analyst, Barclays Capital, Inc.

Q

Great. Thank you very much. Just following up on that kind of comp driving earnings type question, as I look at the fiscal 2018 and the long-term global comp guidance, and you're talking about 3% to 5%, and you're talking about EPS long term of 12% plus. I just wanted to get kind of the thought process around how you arrived at those specifically? Especially from a comp perspective, you just did a 3% in fiscal 2017, and it seems like it was a 3% in fiscal fourth quarter, and that's down from kind of mid to high-single digits over the past five plus years. So I'm wondering what gives you confidence to view that as a conservative bar rather than having to deal with kind of questioning it every quarter, because you're running on the lower end of that. And I guess, it will be the same thing for earnings. Just because you're guiding to 12% plus, but the year just ended, you did 11%, so it doesn't seem as if those are necessarily conservative targets. So I'm just wondering kind of bigger-picture thought process, how you arrive at that, versus perhaps setting the bar lower, and therefore making it easier to exceed.

Kevin Johnson
President and Chief Executive Officer, Starbucks Corp.

A

Well, let me start, Jeffrey. On the question. First of all, thanks for that. I think we go through an entire process. We build a five-year strategic plan, and we build a bottoms up five-year financial plan from that strategic plan, looking at every geography and understanding the dynamics in each of those markets. And it's that financial plan that informs us on the growth in terms of new stores. It informs us on the same-store comparable growth that we expect in these markets.

And I think that – coming out of that strat plan is what drove many of the streamlining activities that you are seeing. Certainly where we look at markets that are slower growth, or don't have the opportunity for as much new store growth, clearly those are markets that are better transitioned to licensed markets, and that's why we've been executing down that path.

You know, the contrast to that then, is China, where we see the growth opportunity that we have ahead in China. And we've been in China, now 17 years or 18 years, and I think if you look at sort of what we have been posting on same-store comparables there, I think, China is the second largest and fastest growing market for Starbucks. It is the second-largest economy in the world. It is an economy that will have a growing middle class, doubling from roughly 300 million people to 600 million people, and so when we look at the global comp numbers, we look at the balance of the opportunities we have, and certainly two powerful growth engines being the U.S. and China. And so, I'll start there.

So if you look then, at the U.S., I think if we look at our U.S. data, it shows us that the overall retail industry disruption that is changing consumer behavior and traffic, data would show that it has had some impact on the overall U.S. retail restaurant sector, which has shown negative traffic here over the last year, where we have been showing positive comps and the traffic that we posted has been above that. Now at some point that turns, so you say, okay, well, in addition to looking for that number to turn, the initiatives that we have been driving, specifically through-put at peak, now the morning peak is the most important day-part at Starbucks. Certainly in the U.S., if you look at the volume that we do. All the actions that John took you through, and the team have been driving have generated demonstrable measurable progress at peak, in this – every quarter since we started those initiatives, and it just keeps getting stronger. We've got continuous improvement plan there that shows us we are growing through-put at peak, and at the same time, we are improving the customer experience. So I think that gives us evidence that certainly we have line of sight to what we need to deliver to be in that comp range in the U.S., and we have doubled down in China. And I think the combination of those two things gives us confidence that a 3% to 5% comp growth for the long-term guidance is the appropriate number to set it at. And from there, I think then the rest of the numbers fall into place.

Operator: Your next question comes from Sara Senatore from Bernstein.

Kevin Johnson
President and Chief Executive Officer, Starbucks Corp. A

Sara? Sara, we can't hear you.

Operator: At this time, there is no response from Ms. Senatore. Her question has been withdrawn, and I will...

Sara Harkavy Senatore
Analyst, Sanford C. Bernstein & Co. LLC Q

Hello? I'm here.

Kevin Johnson
President and Chief Executive Officer, Starbucks Corp. A

Hi, Sara.

Sara Harkavy Senatore
Analyst, Sanford C. Bernstein & Co. LLC Q

Hi, sorry about that. Having some technical difficulties. Thanks.

Kevin Johnson
President and Chief Executive Officer, Starbucks Corp.

A

Sara, we're getting about every other word.

Sara Harkavy Senatore
Analyst, Sanford C. Bernstein & Co. LLC

Q

Okay. You know what? I'm going to let my associate ask the question then. Steph, can you ask the question?

Stephanie Mun-Yee Ng
Analyst, Sanford C. Bernstein & Co. LLC

Q

Okay. So you seemed very positive on the rollout in – or actually in Mobile Order & Pay in Japan, and yet based off the CAP comp it remains kind of a drag on CAP comps. Now that you have taken the business and turned it around, does it make sense to think about licensing it again?

John Culver
Group President-Starbucks Global Retail, Starbucks Corp.

A

This is John. We have no intention of licensing the Japan business. We made a significant investment to buy that business back, because we believe in the long-term growth opportunity in that market. We now operate 1,300 stores there across all prefectures. We opened a record number of 90 stores this year, and the new-store performance continues to be very strong, and when you dig up underneath Japan, and really the numbers around Japan, Scott talked about the afternoon softness that we saw. That was particularly related to our blended beverage LTOs that account for about over 40% of sales during the summer period, but when you go beyond that and look at our core business of espresso, very strong performance. Tea, very strong performance. Food, strong growth there. And we saw momentum in the quarter, particularly in September build. We launched MSR in Japan in the middle of September. We now have nearly 2 million members on the rewards program, and we're excited with the opportunity that the digital flywheel presents for us there.

And then when you look at – in terms of are we growing our share in Japan, given our store growth, given our overall organic growth, we are outpacing the competition and actually taking share in that market. So we are bullish on Japan, and we have a long-term commitment to that market.

Scott Maw
Executive Vice President and Chief Financial Officer, Starbucks Corp.

A

And I would just add a couple financial points to that. If you go back to the deal model that we put together for Japan a few years ago, we're actually ahead of that deal model on every measure, except for comp. So revenue is ahead, profitability is ahead, profit margin is ahead. And that's because of the performance of new stores and the overall performance and strength of the market since we purchased. So we're trying to make sure we don't over focus on comps. We understand it's a challenge in Japan, but once we work our way through this blended mix issue, then you're going to see that profitability come through much more clearly.

Operator: Your next question comes from David Palmer from RBC Capital Markets.

David Palmer
Analyst, RBC Capital Markets LLC

Q

Thank you. Just a quick clarification. I think there's some confusion on this, but could you just touch on, Scott, the profit growth and tax assumptions embedded in your fiscal 2018 guidance? And then just separately a follow-up on initiatives that give you the most confidence that 3% would be the low point for comps. You talked about throughput and then you touched on a variety of other things, including things that would touch on the big three, digital, food, and beverage. If you had to sort of rank order the things that give you the most confidence or you think would be the most meaningful beyond the throughput initiatives, what do you think those would be? Thank you.

Scott Maw
Executive Vice President and Chief Financial Officer, Starbucks Corp.

A

Sure, David. So the overall profit growth, EPS growth on a non-GAAP basis will be 12% to 13%. I did say the tax rate would be 27%, but that's really impacted by the transaction in East China, assuming it closes. So we don't have any assumption of any change in the actual tax regulation in any of our major economies, particularly in the U.S. It's pretty much assumed status quo, but it's lower next year, specifically because of that transaction in East China, assuming it closes. And I think on the strength in comps, I'll hand it over to Kevin.

Kevin Johnson
President and Chief Executive Officer, Starbucks Corp.

A

Yeah, David, in terms of the things that I would stack rank around the initiatives that have, I think, the most impact on confidence of those comps: number one would be throughput at peak. That is the most important day-part, and with the work that's been done, and the roadmap and continuous improvement ahead, we have never been stronger. And so we grow at peak, we grow comps.

Number two, digital. It's predictable, it's powerful, and we're expand – we're widening the aperture of it by opening up Mobile Order & Pay to more customers. That will be another powerful driver of confidence. And the third is food, and with food, we continue to make very good progress that contributes to that. We're now over 21% of the mix, and good reception on what we're getting with the lunch day-part, good performance in the morning, and the continued innovation around beverage. So I think food and beverage innovation pipeline we have is just going to continue to crank, but I think added to that, the throughput at peak and the digital are going to be key drivers, and all of those give us confidence.

Operator: Your next question comes from Matthew DiFrisco with Guggenheim Securities.

Matthew DiFrisco
Analyst, Guggenheim Securities LLC

Q

Thank you. I just have one clarification I just want to ask first and then I have a question. The GAAP tax rate is 27%, and you're not implying that 27% is part of the 12% to 13% algorithm for operating income or EPS growth?

Scott Maw
Executive Vice President and Chief Financial Officer, Starbucks Corp.

A

That is correct.

Matthew DiFrisco
Analyst, Guggenheim Securities LLC

Q

Okay. So it's more comparable the tax rate. Understood. And then was share repurchase included in that?

Scott Maw
Executive Vice President and Chief Financial Officer, Starbucks Corp.

A

Share repurchase is included in that. And in fact, one of the reasons we have accelerating profitability as we move through the year is share repurchases will help earnings per share a little bit more each quarter.

Matthew DiFrisco
Analyst, Guggenheim Securities LLC

Q

Of course.

Operator: Your next question comes from Karen Holthouse from Goldman Sachs.

Karen Holthouse
Analyst, Goldman Sachs & Co. LLC

Q

Hi. A quick housekeeping and then an actual question. Looking at the unit growth guidance in CAP, can you give a sense of how we should think about the breakdown between company and licensed maybe this year and then longer term when you're thinking about your post-business mix changes there? And then thinking about the timeline of some of the things you mentioned as drivers of excitement, my understanding was that a broader expansion of the accessibility to Mobile Order & Pay or this digital relationship was going to be more of a 2019 initiative. Is that something that could actually start to benefit in fiscal '18? And are you seeing any earlier benefits from just the more streamlined sign-up process within the existing stored value platform? Thanks.

Scott Maw
Executive Vice President and Chief Financial Officer, Starbucks Corp.

A

Yeah. Thanks, Karen. We didn't give the ownership split in CAP on purpose. Because of the pending acquisition it was really hard to know. We don't have regulatory approval exactly how the stores are going to open and 100% when we were going to close. But I'll answer the second part of your question because I think it was really around what's it going to be going forward? So I think we said 1,100 stores in CAP, 600 stores in China. If the deal closes, those 600 stores would obviously be all company owned. So you're looking at about 50/50 company-owned and licensed as we move through time. And I think I'll kick the second question over to Matt.

Matthew Ryan
Global Chief Strategy Officer & Executive VP, Starbucks Corp.

A

Sure. Thanks for the question there. With regard to Mobile Order & Pay, we have found a way to accelerate versus our original intention. Now I want to point out that it's not a 'go great immediately' thing. We'll be ramping into it across the year. So it's one of the reasons why we have additional confidence that our business will be gaining momentum throughout the year, number one.

And with regard to the sign-up, we have, in fact started to see ourselves beat the typical seasonality with regard to customer acquisition. We have been talking about the fact that we will be leaning in there. That is precisely what we're doing. So if you've signed up for Mobile Order & Pay recently, you've noticed that the process has gotten better, and we are in recent weeks and months starting to see that in our business. You're going to continue to see us lean in across this year in acquiring digital relationships, first of all, within Starbucks Rewards, but then via other means, including Mobile Order & Pay that doesn't require a stored value card.

Operator: Your next question comes from Brett Levy, Deutsche Bank.

Brett Levy
Analyst, Deutsche Bank Securities, Inc.

Q

Good afternoon. I was just curious, you were – with respect to the Mobile Order & Pay, you had mentioned...

Kevin Johnson
President and Chief Executive Officer, Starbucks Corp.

A

I think we lost him.

Operator: Yes his line has been cleared from the queue. Your next question comes from Greg Badishkanian from Citigroup.

Gregory Robert Badishkanian
Analyst, Citigroup Global Markets, Inc. (Broker)

Q

Great, thanks. So it sounds like the U.S. same-store sales should be around 3% to 5% from your comments. So I just wanted to make sure that that – I kind of read into that correctly. And then what are you assuming for the competitive environment as well as the macro environment? And the headwinds mentioned in your prepared remarks, do you assume that some of those moderate a bit over the coming year or even for your long-term to achieve that long-term target?

Scott Maw
Executive Vice President and Chief Financial Officer, Starbucks Corp.

A

Yeah, I would say if you do the math on our total company comps, they tend to follow very, very closely with the U.S. business just given the size. And on the second part, maybe I'll turn it over to Kevin.

Kevin Johnson
President and Chief Executive Officer, Starbucks Corp.

A

Yeah, I think on the second part, Greg, when we look at the data that we study, we look at a lot of different sources of data, and I'm sure many of them are sources that you use as well, variety of industry studies, credit card data, and other research to track comps in the away-from-home restaurant industry. And I think what it's shown is over the last year, it's been relatively flat with slightly negative transactions, and we know that over time that number continues to grow. And so at some point that turns, but I think we see some evidence near term that that's beginning to happen, but it's premature to call that.

I don't know, Matt, if you want to add any more in terms of the analysis on this, but I think the long-term prospect of – or assumption we made when we looked at the 3% to 5% comps that we set in the U.S. was that that number was going to stay at that point, and that gave us the confidence that this guide gave us upside in the U.S. performance.

Operator: Your next question comes from Dennis Geiger, UBS.

Dennis Geiger
Analyst, UBS Securities LLC

Q

Great. Thanks for the question. I just wanted to circle back on the loyalty program. Just any thoughts how relevant that still will be to grow that program, particularly if Mobile Order & Pay doesn't require it. I guess just building on that, do you have good data or a sense for how big the pool of potential customers can be for that program, given we've kind of been in this range for a few quarters now. And just anything that you could add on this leaning in, certainly linking the card directly, your expectations for that, just any more detail on growing that base, given how strong the performance of that member program is? Thank you.

Matthew Ryan
Global Chief Strategy Officer & Executive VP, Starbucks Corp.

A

Thanks. Matt Ryan here again on that one. We are extremely optimistic about the program as well as growing digital relationships outside of the program. And we have opened up the aperture, if you will, to explore additional ways of acquiring digital relationships. I think a couple things are really important to look at. We have seen 11% year on growth in our membership, and recently we've started to see an uptick because of the improvements to sign-on that we've put into place. But the even more impressive metric is we have seen from members 8% year-on-year growth. That is a function of a couple of things. It is a function of Mobile Order & Pay, but even more important has been the use of personalization, the customized offers and communications we put in people's hands.

We know that when we can talk to our customers through our own channels, like our app, like email, we can get a terrific response out of our customers. If you want to think about it, 8% comp from our members this year. And as we expand the number of people we bring into our digital fold, both inside the program and outside of the program, we see a great deal of upside. Just as a reminder, we have 75 million unique customers coming through our store, and right now we're counting 13.3 million of them signed up for Starbucks Rewards. There is a lot of upside there. And even when you sign up, people who are further down the food chain who are not as engaged with Starbucks, we see tremendous incrementality when they do become directly engaged with us.

John Culver
Group President-Starbucks Global Retail, Starbucks Corp.

A

And I would just add, Dennis, to Matt's comments, in the U.S. specifically around Mobile Order & Pay and the impact that's having, we ended the quarter at 10% of transactions were Mobile Order & Pay and actually accelerated through the quarter where we exited the quarter at 11%. So these digital relationships and the ability to continue to bring customers into the fold is critical.

Matthew Ryan
Global Chief Strategy Officer & Executive VP, Starbucks Corp.

A

And just to pile on there, please bear with me, I think it's important to recognize that we had turned off marketing for Mobile Order & Pay for a good while because we were focused on getting the operations right. It was just toward the end of the quarter that we were able to turn it back on, hence the acceleration up to 11% that John just mentioned, so we're very optimistic about Mobile Order & Pay.

Operator: Your next question comes from the line of Brett Levy from Deutsche Bank.

Brett Levy
Analyst, Deutsche Bank Securities, Inc.

Q

At least we'll try this time. Getting used to this whole technology thing. I'm not quite as good as you guys are. If you could share a little bit more color on what you're looking at in terms of the capital plans and leverage, how you're thinking about the buybacks. Should we assume that this'll just be open market opportunistic? Will you consider things like ASRs out there? And should we think about this as a constant steady-state, pretty seasonal on a quarterly basis? Thank you.

Scott Maw
Executive Vice President and Chief Financial Officer, Starbucks Corp.

A

Yeah, thanks for the question. It will be front-end loaded a bit in 2018, and within 2018 in the first quarter. So if you look at that $15 billion, it's definitely ratably over the three years, but a little bit more in 2018 and a little bit more early in the quarter. We don't plan to use an ASR right now, but that's a tool that we will use if we want to access the market and take the shares out in a large chunk, but right now it'll be opportunistic open market. And we've done some back testing and we actually performed better than an ASR using that. The other thing I would just make sure you understand is the vast majority of that $15 billion will actually come from cash flow in the business. So we will increase debt, we will increase leverage, but the biggest source of that over three years is just the strong operating cash flow within the business.

Brett Levy
Analyst, Deutsche Bank Securities, Inc. Q

Great. Thank you.

Operator: Your next question comes from Nicole Miller from Piper Jaffray.

Nicole M. Miller Regan
Analyst, Piper Jaffray & Co. Q

Thank you, good afternoon. I wanted to ask about Channel Development, and I was wondering if I've calculated this correctly, I think the operating margin is as significant as the CAP region. So do you see that as a powerful growth engine as well? And related to that, could COGS inflation positively impact the top line next year? And then just a very loose follow-on if I may. Could you give some modeling suggestions around removing TAZO, and what's the plan for those proceeds? Thank you.

John Culver
Group President-Starbucks Global Retail, Starbucks Corp. A

I'll take the first part, and then I'll turn the second piece over to Scott to answer it. We remain very bullish on the opportunity that Channel Development presents for us and see it as a continued growth engine. It is a $2 billion business this past year, and the margin is up near 48% overall. In the quarter, we grew top line 8%, which is great, but more importantly, is the share gains that we're seeing both across K-Cup as well as packaged coffee, and when you look at our share growth, it's 2 times as fast as the overall category growth. So if you remember back to Investor Day, we shared that we felt that the overall grocery category for coffee would decelerate. We've seen that, but we continue to capture more than our fair share of the share growth in premium coffee and packaged coffee overall.

K-Cups – we're the number one brand with over 16 share. Our brand, Starbucks, grew 16 times the rate of the category, and 2 times our nearest competitor in the quarter. And total Starbucks, including SBC grew 50% faster than any branded coffee company. So clearly, Channel Development is a growth engine. We are very optimistic about the future. Not only in the U.S., but then also when you look at international, we've got the Anheuser-Busch relationship with Teavana. We're going to double down on Teavana now in channels, and launch RTD nationally. And then also we'll be launching Teavana sachets down the aisle later this year, and so we're excited about that, so we feel very good about the business.

Scott Maw
Executive Vice President and Chief Financial Officer, Starbucks Corp. A

And on the question on proceeds Nicole, I think what I would say is if you look at the broad set of activities that Kevin talked about around streamlining our operations, it includes selling our Taiwan market, licensing our Singapore market, licensing our Germany market a little over a year ago. Selling TAZO, and exiting a couple of other pieces of our business. All of those businesses had lower levels of returns and lower profit and revenue growth rates than the businesses we're investing in. And the biggest one to talk about is obviously East China. So if you add up the proceeds of all four of those transactions, it paid for a material portion of East China. And the returns and growth rate obviously for us China if you look at the numbers we just posted this quarter, are significantly higher. So that's how we're thinking about it. We'll continue to evaluate that as we move forward.

Operator: Your next question comes from Andrew Charles, Cowen and Company.

Andrew Charles
Analyst, Cowen and Company, LLC

Q

Great, thank you. Just to play devil's advocate, why not accelerate the amount of U.S. store models if this is the biggest piece to improving morning throughput, accelerating the rollout of Nitro Cold Brew. I realize it's going to be capital intensive, but provided the expected ROIC was greater than the 25%-plus target and give greater visibility and in resetting U.S. comps, and why not? And also just one clarification, were beverage comps in the quarter, were they 1% or flat in 4Q when you include the drag from Frappuccino and the hurricanes. Thank you.

Scott Maw
Executive Vice President and Chief Financial Officer, Starbucks Corp.

A

John, do you want to start with the renovations, I'll take...?

John Culver
Group President-Starbucks Global Retail, Starbucks Corp.

A

Yeah, I think for us, we continue to focus on our new stores, and obviously existing stores in terms of the renovations. And as we have innovation to bring into those stores, we are planning the capital in order to go in and renovate stores. So Nitro Cold Brew is a great example. We have it right now in approximately 500 stores across the U.S., and we're seeing good growth from that. We have plans to continue to monitor that and continue to grow it. In addition, you're also looking at other innovation that we're going to be bringing into the stores to drive the same store sales.

Kevin talked about plant-based beverages and alternatives. That is a big area of opportunity for us, and our customers are asking for it. We're also seeing very strong growth as it relates to iced and refreshment. Iced and refreshment, in the quarter iced espresso grew 15%, and refreshment grew 24%, so iced and that area of the business presents a big opportunity. And then the last area is how do we continue to capture this opportunity that we're seeing on food and the attach rate that we're seeing. In the quarter, we grew food 15% year-over-year, and food now is 21% of the overall mix of what we're selling through our U.S. stores. We're seeing good strong growth on breakfast sandwiches. We're seeing good strong growth on Sous Vide Egg Bites. We now have that available in all of our stores across the U.S., and then the last area is in the protein bistro boxes, and the impact that those are having. So we remain bullish on the existing stores, and continue to drive more innovation into it, whether that is related to coffee, whether that's related to food, or whether that's related to the digital experience.

Scott Maw
Executive Vice President and Chief Financial Officer, Starbucks Corp.

A

And just to get to the last part of your question, yes, we had 1 point of beverage comp, 2 points of food comp. And I talked a little bit about the mix challenge. It's really an opportunity for us on beverage. John talked a lot about the things that we see to try to drive additional beverage comps. The mix impact on COGS was really not a food-cost issue, but really an opportunity around additional beverage comps. And as we move into the New Year, we've got lots of plans to try to accelerate that.

Operator: The last question comes from the line of Jason West from Credit Suisse.

Jason West
Analyst, Credit Suisse Securities (USA) LLC
Q

Yeah, thanks. Just a couple of clarifications and then a question, first where was the $50 million donation in the P&L? And then Scott, I think you said you expect high single-digit revenue growth this year, including the China deal. Just want to confirm that. And then the bigger question was the margins in the Americas segment were down several hundred basis points in the quarter, the guidance of up margins in that segment this coming year, just can you talk about what's going to change there versus what we just saw in the last few quarters, really? Thanks.

Scott Maw
Executive Vice President and Chief Financial Officer, Starbucks Corp.
A

Yeah, so the foundation donation was in G&A expense. The impact of East China is not in that high single-digit number. It's really in that 2 to 3 additional points that I talked about, which is the net of selling TAZO, licensing Taiwan and buying East China, all of those puts and takes we think add 2 to 3 points on top of that. And then the acceleration in the U.S. business, John, really talked about it, but it is important.

So in this quarter, it was among the highest quarters we've had since we started the significant U.S. partner investment. The impact on margin this quarter, I think, we called it out as 130 basis points. There was also about 40 basis points of impact from the storm, and then 90 basis point of mix. And again, I talked about the opportunity we have in beverage. As we look forward and we look at slight margin expansion, frankly as early as Q1, it's really those things that John talked about that will drive that. Yes, some opportunity on the top line, but really going after waste in the middle of the P&L, going after optimized labor, and when we say optimized labor, those stores that need more labor to drive additional revenue, and those stores that might have a little bit too much labor, and there might be an opportunity to redeploy. So all of those things are focused at driving additional margin. Little bit of lower partner investments help year-over-year, but it's really about getting after the middle of the P&L.

Operator: I will now turn the call over to Mr. Shaw for his closing remarks.

Tom Shaw
Vice President-Investor Relations, Starbucks Corp.

Yeah, thank you. Before closing today's call, we wanted to give you visibility into our investor outreach calendar for 2018. Specifically related to two events that we have tentatively planned. During the week of May 14, we'll be in Shanghai for our China investor tour, which will include an experience at our Shanghai Roastery, presentations from our local leadership team and tours of several of our stores in the city. We'll provide more details as dates are finalized over the next couple of months.

Then concluding the year, we'll once again have our bi-annual Investor Day in December to provide a deeper understanding of our global strategy and financials. In the meantime, we look forward to speaking with you again on our first quarter 2018 results conference call, which has been tentatively scheduled for Thursday, January 25. Thanks again, and have a great evening.

Operator: This concludes Starbucks Coffee Company's fourth quarter and fiscal year 2017 earnings conference call. You may now disconnect.