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Starbucks Corp. (SBUX)

Q3 2024 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon. My name is Diego, and I will be your conference operator today. I would like to welcome everyone to the Starbucks Third Quarter Fiscal Year 2024 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]

I will now turn the conference call over to Tiffany Willis, Senior Vice President of Investor Relations. Ms. Willis, you may now begin your conference.

Tiffany Willis
Senior Vice President, Investor Relations, Starbucks Corp.

Thank you, Diego. Good afternoon, and thank you, everyone, for joining us today to discuss Starbucks third quarter fiscal year 2024 results. Today's discussion will be led by Laxman Narasimhan, Chief Executive Officer; and Rachel Ruggeri, Executive Vice President and Chief Financial Officer.

This conference call will include forward-looking statements which are subject to various risks and uncertainties that can 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 discussed in our filings with the SEC, including our latest annual report on Form 10-K and quarterly report on Form 10-Q. Starbucks assumes no obligation to update any of these forward-looking statements or information.

GAAP results in third quarter fiscal year 2024's comparative period includes several items related to strategic actions including restructuring and impairment charges and other items. These items are excluded from our non-GAAP results.

All numbers referenced on today's call are on a non-GAAP basis unless otherwise noted or there is no non-GAAP adjustment related to the metric. As part of our non-GAAP results, revenue, operating margin, and EPS growth metrics on today's call are measured in constant currency whereby current period results are converted into United States dollars using the average monthly exchange rates from the comparative period rather than the actual exchange rates for the current period excluding related hedging activities.

For non-GAAP financial measures mentioned in today's call, please refer to the earnings release and our website at investor.starbucks.com to find reconciliations of those non-GAAP measures to their corresponding GAAP measures.

This conference call is being webcast and an archive of the webcast will be available on our website through Friday, September 13, 2024.

And lastly, for your planning purposes, please note that our fourth quarter and full fiscal year 2024 earnings conference call has been tentatively scheduled for Wednesday, October 30, 2024.

And with that, I'll now turn the call over to Laxman.

Laxman Narasimhan

Chief Executive Officer & Director, Starbucks Corp.

Thank you, Tiffany, and thank you for joining us this afternoon. Let me start by laying out our results for this quarter. Our Q3 total company revenue was $9.1 billion, up 1% year-over-year and 6% over Q2. Our global comparable store sales declined 3% year-over-year driven by a negative 2% comp growth in North America and a negative 14% comp growth in China and partially offset by strong performance in Japan. Our global operating margins contracted by 70 basis points to 16.7% and overall earnings per share for the quarter was $0.93.

Our total company results were in line with guidance, but international performance, particularly in China, was challenged. We are not satisfied with the results, but our actions are making an impact, leading business and operational indicators are trending in the right direction ahead of our financial results and our runway for improvement is long.

We see green shoots in our US business driven by the three-part action plan outlined last quarter. First, meet and unlock capacity for new demand through a relentless focus on improvements to our US store operations and on elevating the experience we create for our partners and customers. Second, attract new customers and drive transaction growth by launching and integrating more exciting new products with relevant marketing while maintaining our focus on core coffee forward offerings. And third, reach new customers, and demonstrate our value by making sure customers believe the Starbucks experience is worth it every time.

First, our largest opportunity, meet and unlock capacity for new demand. A relentless focus on improving operational execution across our nearly 10,000 US company-operated stores is the cornerstone of our near term plan. While it is early days of progress, our plan is working.

If you walk away from today's call with one thought, let it be the significant changes and long-term upside potential taking place within our US stores and across our end-to-end supply chain to unlock growth, enhance the customer experience, and drive cost efficiencies.

Within our stores, we've seen material positive momentum across core store health and performance metrics with notable improvements in partner scheduling and turnover, critical store issues, and inventory management. Stores ranked in our top two operational performance quartiles reached a new high during the quarter, a 28% upwards shift from Q2, but we have more opportunity.

Our focus on operational excellence driven by Reinvention plan has led to a multi-second year-over-year improvement in out-of-the-window times, a nearly 50% reduction in calls received by our Customer Contact Center for my order took too long and Mobile Order & Pay and delivery uptime rates of 99%. These are key indicators of our work to drive growth by addressing customer wait times, product availability, and the customer experience.

This quarter, we also introduced phase one of our Siren Craft System, which includes several process and partner driven enhancements to our US store operations. Changes include a new peak time play caller role, strategic investments in partner hours, training, new routines, simple enhancements to technology, and an evolved beverage build process. Early deployment across 1,200 stores demonstrated a material incremental improvement across key performance, throughput efficiency, and reliability metrics. Encouraged by this, we fully deployed Siren Craft System process improvements across our entire portfolio of US company-operated stores this week.

Later this quarter, we will begin rolling out a simple refit to our espresso machines which we expect to improve espresso throughput by up to 15% without compromising quality, and with a minor software change in our store production systems, we have a similar ability to improve food throughput. When paired with Siren System equipment announced as part of our Reinvention plan, these new processes become a force multiplier that we expect to drive a true step change improvement.

Early assessments demonstrate the capability to drive a 10 to 20 second wait time reduction and a resulting comp opportunity range of 1% to 1.5%.

Leveraging our Deep Brew analytics platform, we have identified customer experience outlier stores, approximately 10% of our network, and have developed targeted plans to address and improve them including accelerated Siren System deployment. Similarly, we are accelerating the pace of our new store builds and renovations with 580 net new builds and more than 800 renovations planned in North America for FY 2024.

Store development efforts are focused on Tier 2 and Tier 3 cities where we see population growth and forecast both underserved demand and high incrementality. Increasingly, these new store builds and renovations also include Siren System equipment. In line with prior guidance, we remain on track to deploy equipment in less than 10% of company-operated stores by the end of FY 2024 and about 40% by the end of FY 2026.

Building on our pilot, Starbucks and Gopuff have agreed to terms for an expanded relationship to open 100 delivery-only kitchens across the US. We're also accelerating the rollout of digital storyboards with target deployment across most US stores in the next two years, a year earlier than originally anticipated.

Lastly, we're working in other ways to enhance the café experience. This includes new and expanded seating options that elevate many stores, while upholding a safe and inviting place for partners and customers.

A key outcome of our operational efforts has been material and sustained improvements to the partner experience. Driven by precision partner-centric staffing and scheduling efforts, we ended the quarter with a new post-pandemic low partner turnover rate, the best shift completion rate in two years and a 13% improvement in average hours per partner, now the highest on record. These initiatives create more stability in our stores, provide more predictability for our partners and sustain our experience flywheel.

Looking beyond our stores, we continue to realize new efficiencies, cost savings, and performance improvements across our end-to-end supply chain thanks to strong support from our suppliers and we see even more headroom. We have a structured process to realize significant continued improvements across our end-to-end supply chain. We are ahead of plan on productivity. We expect our productivity to drive efficiency and unlock capital from areas that don't touch the customer.

In turn, these savings will enable us to target investments that drive value for our customers beginning later in Q4, reigniting our North American flywheel for growth. We're early days on this journey, building both our strategic sourcing and revenue management capabilities.

Our second priority is to drive demand through relevant product innovation with coffee at our core. We've seen meaningful improvement here as well. This quarter, we drove traffic into our stores through an engaging and innovative pipeline of products supported by integrated marketing campaigns.

Cold share was up 1% year-over-year, representing 76% of our beverage mix through the quarter. Our newly formulated received positive feedback. Our strength in cold espresso innovation continued to drive the platform's growth, up 4% year-over-year. And we launched Starbucks Milano Duetto, whole bean coffee in Milan, ahead of a global launch this October.

Beyond coffee, our new Summer-Berry Starbucks Refreshers, beverages with Pearls, drove the highest week-one product launch in our history. Their success buoyed the entire Starbucks Refreshers beverage platform to an all-time high during the quarter.

As mentioned in Q2, we continue to build out our 24-month product pipeline while accelerating our pace of innovation. For example, recognizing the growing appeal and opportunity created by the energy category, we launched a new Handcrafted Iced Energy beverages across our US stores in just three months compared to a normal 12 to 18 months.

Looking forward, we believe our Q4 product offerings, including the return of Pumpkin Spice combined with supporting marketing activities and offers, provides the right formula to drive customer interest, demand, and deeper engagement with both new and existing customers.

Our third and final near-term priority is to reach new customers and demonstrate the value we offer by ensuring the Starbucks experience is worth it every time.

Recognizing the premium position of our brand, we've been measured in our use of offers. During this quarter, only 14% of our transactions were driven by offers compared to a competitor average of 29%. Of offer-driven transactions, 10% was star-based offers targeted to Starbucks Rewards Members. Only 4% were driven by price-based offers.

Our best offers are in the app. Together, offers and other integrated marketing activities when paired with exciting product innovation successfully grew Starbucks Rewards membership, reactivated many lapsed rewards members, and drove customer traffic on promotional days and product launch weeks.

Active US Starbucks Rewards members grew to 33.8 million during the quarter. Members across every decile increased the frequency of their visits. We're focused on the continued growth of the program because the average active member spends materially more annually and drives a higher lifetime value for the business than a non-member.

Research also tells us that the most inactive Starbucks Rewards members don't realize they've lapsed. This demonstrates a continued opportunity to drive return visits, active member growth, and deeper customer loyalty. Looking forward, we will continue to use more targeted offers coupled with select pricing actions funded by efficiency initiatives to drive traffic and conversion. We plan to leverage a mix of paid media, acquisition and retention, disruptive signage and partner education to drive transactions and increase the frequency of visits, with a focus on product launches and continued Starbucks Rewards member growth.

It's worth remembering the ubiquity of the Starbucks brand and our ability to intercept customers. For instance, our business is up 13% in airports and up 9% in hotels – pointing to these strengths. Leveraging our brand and our ability to intercept customers while demonstrating value – not just in price but through a premium experience remains a sizable opportunity across our entire store portfolio.

Moving on to digital, as part of our action plan, we made continued improvements to our Starbucks App, including wait time algorithm enhancements that have improved order ready accuracy by nearly 50 percentage points. This combined with in-app offers helped drive a 10% year-over-year growth in Mobile Order & Pay revenue and a 7% year-over-year increase in MOP transactions.

Looking deeper, our data shows that one in four non-Starbucks Rewards members want the ability to use Mobile Order Pay. Nearly 80% of those customers don't want to join a rewards program or create an account to do it. In response, we opened MOP for all to provide those customers the convenience they seek by removing perceived barriers to entry.

We believe these enhancements to the digital experience, coupled with more effortless ordering, will continue to drive Starbucks Rewards membership over time, with customers increasing frequency and spend. Once customers are in our digital ecosystem, they're more likely to remain engaged across channels and drive greater lifetime value.

In summary, our plans are beginning to work. We are recovering our brand from misperceptions. We're rebuilding the operational foundation of our stores and supply chain. We're reducing costs to support investments. We're sustaining partner experience improvements. And we're working to make the Starbucks experience worth it every time.

While it's early days, I'm confident in the trajectory of our US business and the operational improvements we're making and I'm reassured by the impact our work is expected to deliver in FY 2025 and beyond.

Looking outside the US, we've continued to see weakness in parts of our international business and strength in others. Headwinds persist in the Middle East, Southeast Asia, parts of Europe, driven by widely discussed misperceptions about our brand. In some European markets consumers are stretched. At the same time, we see significant strength in markets like Japan and parts of Latin America.

China is one of our most notable international challenges and an area I'd like to talk about in more detail.

The competitive market dynamics in China are reflected in our recent results. We've continued to face a more cautious consumer spending and intensified competition. In the past year, unprecedented store expansion and a mass segment price war at the expense of comp and profitability have also caused significant disruptions to the operating environment. Still, we have made progress in important areas.

Through Q3, metrics like average daily transactions, weekly sales, and operating margin improved sequentially quarter-over-quarter. Starbucks Rewards members grew by 1.6 million to a record high 22 million active members and customer connection scores reached a new high while partner turnover reached a new low.

We've built an amazing business in China over the past 25 years, a business for China built by an outstanding local team. We've pioneered the growth of the premium coffee industry in market with our Starbucks and Starbucks Reserve brands and brand equity remains distinctive. We have incredibly committed and expert partners with an unmatched depth in coffee and craft. Our stores are distinctive and industry leading and our supply chain is world class.

New stores have expanded our presence to more than 900 county cities and continue to drive exceptional cash on cash returns and a payback of less than two years. We're looking beyond near term challenges and towards long-term opportunities in the market.

We built Starbucks in China around three principles. A great customer experience is grounded in a great partner experience. Our coffee will always be distinctive and high quality. With low penetration relative to other markets, which provides continued headroom, our beautiful stores will celebrate the culture and traditions of China and their local communities.

Even in a challenging market, we have stayed true to these principles and our relative premium positioning. This is reflected in the competitive margins we have sustained in the face of price competition.

Over the past 25 years, we've gone through different phases of growth in China and have relied on different strategic partnerships to grow our business and capabilities like joint ventures and strategic partnerships in technology, real estate, and supply chain. As we look forward, we see higher growth and margin opportunities in China. We're building the next generation of Starbucks, grounded in our premium brands and with a business that is even more digital, innovative, and locally relevant.

To do so, as our strategy evolves, we are in the early stages of exploring strategic partnerships to further enhance our competitive position to accelerate growth and innovate to win in the long term in China. We remain completely committed to our business and our partners in China for the next 25 years and beyond. The long-term opportunity for us is significant.

Before I close, I would like to confirm that Elliott Management is a shareholder in our company and our conversations to date have been constructive.

On the business, my continued confidence is rooted in the focus, energy and effort of our partners across the business and around the globe. Our growing culture of focused innovation and relentless execution continues to enhance our capabilities, operational muscle, and executional discipline driving forward our action plan and our long-term Triple Shot strategy while helping return the business to sustainable algorithmic growth.

And with that, I'll turn this over to Rachel.

Rachel Marie Ruggeri

Chief Financial Officer and Executive Vice President, Starbucks Corp.

Thank you, Laxman, and good afternoon, everyone. As Laxman shared, we're seeing progress against our three part action plans. Additionally, our efficiency efforts which are tracking ahead of expectations, partially offset investments associated with the cautious consumer environment. With continued focus on our action plans, efficiency efforts and disciplined operational execution, we expect progress as we close out the year.

With that, let me turn to our results. Our Q3 consolidated revenue was $9.1 billion up 1% from the prior year, demonstrating sequential revenue growth quarter-over-quarter, consistent with what we guided.

Revenue growth over the prior year was driven by 8% net new company operated store growth partially offset by a 3% decline in comparable store sales from a 5% decrease in transactions and a 2% increase in average ticket as we continued to navigate through a value driven consumer environment.

US led the average ticket increase of 4% driven by pricing and multi-beverage orders. The increase in average ticket in the US reflects how our innovative products and thoughtful promotions resonated with customers in our quest to offer enhanced value indicating that our action plans are starting to take hold.

Shifting to transactions, US posted a comparable transaction decline of 6% primarily driven by non-SR members. Across SR customers, as Laxman shared, we saw improved frequency across all deciles. Mobile Order & Pay in the US remained strong in the quarter with positive year-over-year total transaction growth of 7% as customers continue to value both the experience and convenience of the Mobile Order & Pay channel.

As we open our app for all with MOP guest checkout, which launched earlier this month, we expect to create and deliver value across a broader population expanding our universe of known customers to deepen engagement, driving increased frequency and spend.

In addition to strong SR program growth in the US, we saw strong SR program growth in China. SR members grew to a record 22 million 90 day active members in China and in June we also enhanced the program through extending rewards and introducing new diamond tier which provides exclusive benefits to our most loyal SR members. We're pleased with the SR member growth across both the US and China and expect to see the benefit from this growth in future quarters as new members provide a longer term benefit.

Shifting to margin, our Q3 consolidated operating margin contracted 70 basis points from the prior year to 16.7% primarily driven by increased promotional activities, investments in store partner wages and benefits as well as deleverage. The contraction was partially offset by pricing and our continued execution against Reinvention related in-store operational efficiencies as well as out-of-store efficiencies, which primarily center around our supply chain.

As you've heard Laxman discuss, we're focused on improving operational execution and efficiencies which is now more important than ever as we build resiliency in our business. Our efficiency efforts are built on creating sustainable improvements in our operations and end to end supply chain allowing us to both reinvest in our business and drive margin expansion. A testament to these efforts includes the achievement in excess of 200 basis points in year-over-year efficiency gains as of Q3 across both in-store and out of store areas, manifesting throughout our business in reduced store operating expenses and product and distribution costs, respectively. Collectively, these line items represent approximately 85% of our annual spend.

Our in-store focus, a combination of efficiencies in staffing and scheduling as well as enhancements in our store equipment and new store format design has fueled a reduction in partner turnover, creating greater stability in our stores. We believe that stability not only creates opportunity to nurture stronger connections with customers, but also increases productivity which translated to roughly 110 basis points improvement in store operating expense in the quarter.

Our efficiency focus also extends outside of the store as we've been taking a hard look across our supply chain and other areas including G&A.

As Laxman shared, we're working collaboratively with suppliers to identify opportunities to leverage our scale for cost reductions without compromising product quality or distribution timeliness which led to meaningful savings in the quarter of approximately 100 basis points between rebates and rate savings.

In addition, we believe our end-to-end supply chain focus gives us the opportunity to increase inventory availability with the right products at the right time, enhancing the customer experience while reducing waste.

As we've shared, G&A was elevated at more than 7% of revenue through Q2 as we have deliberately invested in resources to continue to grow our technology capability. We have, however, reduced G&A in Q3 and expect it to remain closer to 6% of revenue in the second half of this fiscal year as we balance investments for our long-term growth.

When considering our progress this fiscal year, our in-store and out-of-store year-to-date efficiency efforts collectively amounted to nearly 300 basis points of margin improvement. Our significant efficiency runway, coupled with sales growth, gives us confidence to drive margin expansion over time. Given this, we have ample opportunities to deliver above our initial goal of $3 billion driving to $4 billion in efficiencies over the next four years.

Q3 EPS was $0.93, down 6% from the prior year. The decline was driven largely by the cautious consumer environment which in response drove increased promotions and marketing in the quarter, partially offset by our efficiency efforts. Additionally, our higher effective tax rate had a $0.03 unfavorable impact driven by fewer discrete items relative to the prior year.

With segment results being discussed in detail in today's Q3 earnings release, I'll now touch on our capital allocation and financial resilience and then move into guidance.

As a reminder, our disciplined approach to capital allocation continues to drive financial flexibility, allowing us to continue to make the necessary investments in our business to drive long-term growth. Our new stores continue to be a meaningful part of our growth equation, with approximately 85% of our CapEx allocated to our stores, both new stores and renovations. These high return, growth oriented investments have superior economics while adding incrementally to our business.

Even with over 16,700 stores across the US and another 7,300 in China, we have abundant white space ahead particularly as populations continue to move to more suburban and rural areas. Take a Tier 3 market in the US for example, a place like Joplin, Missouri. A drive-thru in that market boasts a year one ROI in excess of 65% with cash margins approaching 30% and a payback period of less than two years. Year one AUVs reach approximately $2 million with opportunity ahead as we build out the trade area. Importantly, our new store revenue is highly incremental adding an average of nearly 90% to the trade area attained by our world-class store development partners and their rigorous work that leverages AI-assisted strategic site selection process.

We see that in China as well. Take a new county city, for example. We're in only about 900 of the nearly 3,000 across the market. Today, we see year-one ROI as high as 70% with cash margins averaging over 30% as we successfully manage both store development and operating costs even in the current macroeconomic backdrop. We believe this is a great investment and accretive to shareholder value, building out the long-term opportunity.

With our disciplined approach to capital allocation, underpinned by our strengthening store portfolio, we are reinforcing our financial resilience while remaining committed to our compelling dividend. We continue to target an earnings payout ratio of approximately 50%, near the top end of growth companies of our size and scale, resulting in a significant portion of our earnings going directly back to our shareholders.

And currently, we have maintained a leverage target below 3 times lease-adjusted EBITDA, ensuring a strong financial foundation, and consistent with our investment-grade credit rating of BBB+, which allows us to continue to access capital efficiently. Collectively, our disciplined approach enables us to preserve both balance sheet strength and flexibility, positioning us to successfully navigate through the current macroeconomic environment.

Moving to our fiscal year 2024 guidance, we are encouraged with our progress this quarter and we're pleased to reaffirm all metrics of our full-year 2024 guidance. Our confidence is underpinned by the results of our action plans, coupled with the continued efficiency unlock both in and out of store.

In summary, here are key takeaways from my discussion today. First, we are seeing progress against our action plans. Second, our efficiency efforts partially offset investments associated with the cautious consumer environment. Third, we believe our financial fortitude and disciplined capital allocation strategy positions us well for the long term. And last, our full year 2024 guidance remains intact.

Before I close, I want to acknowledge all of our partners across the globe, working tirelessly each and every day to elevate the Starbucks Experience in our stores, at our roasting plants and in our support centers. You are and always have been our superpower. Thank you, partners.

And with that, we'll open the call for questions. Operator?

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] In order to allow as many questions as possible, we ask you to please limit yourself to one question at a time. We will come back for follow-up questions as time allows. Your first question comes from Brian Harbour, Morgan Stanley.

Brian Harbour
Analyst, Morgan Stanley & Co. LLC

Q

Yeah. Thank you. Good afternoon.

Laxman Narasimhan
Chief Executive Officer & Director, Starbucks Corp.

A

Hello, Brian.

Brian Harbour
Analyst, Morgan Stanley & Co. LLC

Q

I wanted to ask a couple of things on kind of the margin and cost side. First of all, G&A, could you talk more about what actions were taken there? Do you still see that as kind of a source of leverage as we go into fiscal 2025? And then on the store side, you're obviously generating quite a bit of efficiency. I think you alluded to reinvesting some of that. Where will that go? And then as we also kind of think to next year, is there some continued need for reinvestment, whether it's in labor or certain other things? Could you shed some more light on that?

Rachel Marie Ruggeri
Chief Financial Officer and Executive Vice President, Starbucks Corp.

A

Sure. Thanks, Brian. Let me start with the G&A actions. So in the quarter, our G&A actually declined year-over-year by about 5% and the drivers of that include performance-based compensation, so lower performance-based compensation, coupled with lapping over some foundation investments from the prior year. In addition to that, given the environment, we made some deliberate decisions to focus on cost efficiencies, which helped us offset some of the investments we've made in wages and benefits as well as the investments we've made in technology. We'll expect that to further into Q4. As we look to the out years, we will continue to drive leverage in our G&A as part of our overall efficiency focus and efforts.

Now, on the store side, you asked about reinvesting, where does that go. And as far as our in-store and out-of-store efficiencies, those investments largely this year have helped to support the promotional activities as well as the investments we've made in our partner wages and benefits.

Now, as we look towards next year, we will continue on our path of efficiency efforts. Those efforts will help us to be able to unlock the capacity to be able to reinvest back into our business in a sundry of different areas but it will also allow us to drive margin expansion.

So I think that answered all of your questions. Thank you.

Operator: Thank you. Your next question comes from Sara Senatore with Bank of America. Please state your question.

Sara H. Senatore
Analyst, BofA Securities, Inc.

Q

Great. Thank you very much. I wanted to ask about the comp composition. So I think, Rachel, you mentioned average check benefited from multi-beverage orders, which I guess suggests that perhaps you're not seeing premiumization or customization anymore but rather just increased group sizes. And then you also mentioned pricing. How much price you have year-over-year, if you could give any color on that. And then the final piece, you talked about much lower promotional intensity or mix than what we see from some of your competitors, but I'm trying to understand how does that 14% compare perhaps to what Starbucks might have seen in the past. Thanks.

Rachel Marie Ruggeri
Chief Financial Officer and Executive Vice President, Starbucks Corp.

A

Sure, Sara. Thank you for the question. I'll start with the 4% check. So in the US business, our ticket comp increased by 4%. And as I shared in my prepared remarks, that does include – about 25% of it was related to beverage attach or multi-beverage orders in response to our promotional offers. So it showed that our customers responded well to our offers, so that's really the driver of it.

We aren't seeing the customization and the personalization in the same way because our offers were much more targeted and driven around specific beverages as well as overall beverage attach. And so as a result of that, that drove the ticket in the quarter, but we were pleased with that because it shows that customers responded well to those offers.

Now when we think about price year-over-year in that 4% ticket, I would say the remainder of the ticket, about 75% is really net price. That includes everything from pricing moves including the increases that we took in California coupled with the promotional offers. So I'd say that's a net pricing impact on that 4%.

And in terms of the promotional intensity, I'll turn it over to Laxman in a minute, but what I can say about the promotional environment is we've been very measured from a promotional standpoint given the fact that we have a premium positioning as our brand and so the majority of our promotional efforts were focused on driving growth in our Starbucks Rewards membership because we know that those members tend to increase their value for us over the lifetime. It's a more efficient way for us to promote.

And in the quarter we were pleased with the fact that between the offers and the marketing activities we were able to grow our Starbucks Rewards membership in the US as a result of that. We also saw traffic increase on days where we had offers as well as days where we had new product launches so that also gave us some encouragement just in terms of the effectiveness of our offers.

And with that I'll turn it over to Laxman.

Laxman Narasimhan
Chief Executive Officer & Director, Starbucks Corp.

A

Sara, just to build on the question that you asked and Rachel's response, the Starbucks brand is grounded in the idea that if you exceed the partner expectations you will exceed the customer expectations and it is in this experience that we deliver the premiumness of the brand and when you look at the words worth it for the Starbucks Experience, what we measure in our work and brand equity is not just about price, it's about the quality, the distinctive quality, the product customization that you mentioned, the consistency of the experience that we create both in stores and digitally delivered at a price that customers believe is worth it when they come into the store to transact with us or when they transact with us across channels.

Now one of the things that we have been very careful about is that given the premiumness of the brand we've been very careful about the offers. And as Rachel said, it is at a lower intensity than it is for some of the other brands. What we've tried to do is focus on the Starbucks Rewards members. For our business, 60% of our revenue comes from the SR program and 40% comes from the non-SR program.

And what we've found is that some of these offers that we have done particularly for Starbucks Rewards members has helped drive engagement and incremental visits. We talked a bit about the fact that we've seen engagement go up in every decile of the Starbucks Rewards members.

If I look at our non-SR customers which is about 40% of it what we've been working on is ensuring that we give them offers to come in and become part of the SR program. Additionally, they've told us, about a fourth of them tell us that they want the digital convenience, but they don't necessarily want to be part of the program so we've done things around how we open up the app for them to order and get the digital convenience.

What we see over time is for the non-SR customers, we still have the opportunity to target price investments funded by the progress we're making in our efficiency program and all the way brings it back to our three part action plan in terms of what we're doing to continue to deliver the kind of premium experience Starbucks is about.

Operator: Thank you. Your next question comes from Jeffrey Bernstein with Barclays. Please state your question.

Jeffrey A. Bernstein
Analyst, Barclays Capital, Inc.

Q

Great. Thank you very much. My question was on China. The headwinds Laxman as you mentioned are seemingly large, the comp is down 14%. I think you mentioned or just highlighted the ramp in competition and the macro challenges and the price wars. But with that said, I know you mentioned exploring strategic partnerships. And you've had partnerships in the past. Just curious if you could provide some more color. I know in the past the Board has evaluated alternatives such as the licensing of China, similar to other multi-nationals QSRs which would kind of allow you to the participate in the growth but mitigate the volatility and reduce capital needs. I'm just wondering what your thoughts are on that, whether that was the reference you made earlier, maybe some of the pros and cons as you contemplate the potential for those strategic alternatives such as licensing. Any color would be great. Thank you.

Laxman Narasimhan
Chief Executive Officer & Director, Starbucks Corp.

A

Thanks so much. We've built a distinctive business in China with both the Starbucks and Starbucks Reserve brands that are relatively more premium relative to what we have in the market and we've got 60,000 partners, 19,000 of them who are black aprons and coffee, and so the depth of coffee expertise we have is tremendous.

Additionally, as we look at the really long term, the potential in this business is amazing. I mean, we've essentially very early days given the per caps we see and the headroom that it provides, so the stores, the brand, the partners, the supply chain, the digital presence we have, all are distinctive advantages but as you rightfully said there's been quite a change in the competitive environment and we've been very entrepreneurial. I mean, 25 years ago when Howard went to China we've created a specialty coffee industry from pretty much nowhere and we've been very entrepreneurial and we've looked at various ways of making that happen including joint ventures and partnerships, strategic partnerships in technology, real estate and supply chain.

We're frankly at the very early stages of this and so I don't want to necessarily comment specifically on any one option versus another. But we're in the early stages. And we recognize that what we want to be sure of is that we are further strengthening our advantage in this market because the long-term opportunity for us is significant and we will update you as we make progress on this effort in terms of exploring these strategic partnerships.

Operator: Thank you. And your next question comes from Peter Saleh with BTIG. Please state your question.

Peter Saleh
Analyst, BTIG LLC

Q

Great. Thank you. I think, you guys have mentioned that traffic was down 6% in the US and the majority of that was due to the non-Rewards customers, which makes up call it 40% of your business. That's a pretty substantial decline in that customer base, probably a double-digit decline in that customer base, so can you just talk a little about where you think these customers are going and why is it that it's such a steep decline in this customer count in just this segment. Thank you very much.

Laxman Narasimhan
Chief Executive Officer & Director, Starbucks Corp.

A

So first of all, I think, we are operating in a challenging consumer environment. You see the impact of that in away from home consumption. If you look at our business at home, the grocery store with our brands, you're seeing volume increase, you're seeing share increase in a category that's in decline, but we see volume increase in home. In our ready-to-drink business we're seeing clearly that that has some challenges, but with the work that our joint venture team is doing we're seeing progress there.

But away from home consumption you see the impact of the challenging consumer environment. What we're focused on is what is it that we can do to control what we have and so the Starbucks Rewards members you see greater engagement. That is 60% of our revenue. Clearly if you look at the sort of lower decile of the Starbucks Rewards program we see opportunity even there for them to increase their visitations but if I look at what we're seeing with our non-SR customers, we still maintain the number one position in terms of coffee shops visited from the research that we do internally and for the equity work we've done. So I think that this is a statement around the overall environment.

We know that there are things that we can do in order to communicate value better to our non-SR customers which is why we've opened up the app for all starting this quarter and once they come in and once they see what's happening inside, the convenience of the mobile order pay channel they will get exposed to what we have inside the app and we know that we have an opportunity as we look at the end-to-end efficiencies that we can get in our supply chain that we can target price investments in those areas that will help them realize the price proposition that we have overall.

If you really step back and look at us, we've been very disciplined over the last many years. We've taken less pricing than many but we also recognize the environment we're operating in is challenged and so I think what you'll see us do is be measured in the way we do this and do it through the app and target price investments where appropriate, leveraging off the efficiency work that Rachel spoke about.

Operator: Thank you. Our next question comes from Jon Tower with Citi. Please state your question.

Jon Tower

Analyst, Citigroup Global Markets, Inc.

Q

Great. Thanks for taking the questions. I guess maybe first a clarification, and a question. Rachel, you mentioned the $4 billion in savings, just want to ensure that's a gross or net number. And then I guess maybe going to the Siren stations that you've talked about, I know, you're still on track to get 40% or less than 40% done in North America by the end of fiscal 2026. Can you talk about what you're seeing with respect to returns and what's the impediment to accelerating that type of remodel schedule, picking it up, say, instead of less than 40% by the end of 2026, picking that up to 50%, 60% or pulling forward more to current fiscal 2025, say.

Rachel Marie Ruggeri

Chief Financial Officer and Executive Vice President, Starbucks Corp.

A

Jon, I'll start with on the $4 billion of savings over the next four years, that is a net number. So we have obviously a larger gross number to ensure that we can deliver on that. So that's the way I'd think about the savings.

Laxman Narasimhan

Chief Executive Officer & Director, Starbucks Corp.

A

On your second question, on the Siren Craft, on the Siren Systems and the equipment deployment, well firstly, we've deployed the process improvements across all our stores in the US this week. This has been very well received. They're inclusive of the new routines, the training, the beverage builds, the partner on investments that we will see transaction impact with that.

Now, we have matched our Siren System equipment rollouts with the renovations and store builds, because of the returns that that gives us. But it's not stopping us from actually using those Siren System equipment in order for us to debottleneck these outlier stores, and as I mentioned in my prepared remarks, with the work we've done with Deep Brew and the analytics that we have, there are 10% of our stores that have the highest customer service outages. For these 10% of stores, that is less than 1,000, there's work going on store by store and what we're doing store by store is to look to see this combination of process improvements, how we run the stores, as well as looking at our renovation cycle to potentially re-sequence them in order for us to bring the Siren Systems in an accelerated fashion to help us debottleneck these stores.

Now, later this quarter we're going to start rolling out a couple things that will help us attack some of the bottleneck areas we see. For example, this retrofit to our espresso machines, same quality, higher throughput, we're going to see the rollout start to over 6,000 espresso constrained stores starting next quarter. We're doing the same thing with some of the software changes we're making around food and how we drive throughput there.

So these are targeted sequenced efforts that will have high impact on those stores with the greatest constraints.

You will see Clover Vertica be in all stores by the end of financial year 2025. So we're going at this not just waiting for the whole system, but looking at portions of it that we can bring in, in a more accelerated fashion, in order for us to drive throughput in the stores.

Rachel Marie Ruggeri

Chief Financial Officer and Executive Vice President, Starbucks Corp.

A

If I would just add one more point to that, is I think it's important to note that the Siren System, the equipment is a major overhaul to our overall stores, our engine. It requires quite a bit of CapEx as well as quite a bit of change management so we intentionally leverage the renovation and new store process because it allows us to optimize the costs, while take advantage of downtime so that's also an important note in terms of how we've been thoughtful about how we roll these systems out more broadly.

Operator: Your next question comes from Sharon Zackfia with William Blair. Please state your question. Sharon Zackfia, your line is open. Please unmute yourself. All right. We'll move on to the next question. And our next question comes from David Tarantino with Baird. Please state your question.

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

Q

Hi. Good afternoon. I just wanted to follow-up on the US business, a lot of encouraging commentary about some of the internal metrics you're seeing in the business there. But I was hoping maybe you could talk about how that's translating to sales performance and whether you're already starting to see sales responding to some of the progress you're making and maybe more specifically if you expect the fourth quarter comp growth or transaction growth in the US or North America to be better than what you saw in the third quarter. Thanks.

Laxman Narasimhan
Chief Executive Officer & Director, Starbucks Corp.

A

Let me start with the three part action plan that we had in place. The first one was fixing our stores. And I think that we're making strong progress here and so if you just look at examples of MOP, the growth rate we had quarter-over-quarter which was a – sorry, year-over-year, which was a 10% growth. The uptime that we have in MOP obviously big improvements. So that's an example of the kind of improvements that we're seeing.

Our drive-thrus are more efficient. I mean, the multi-second improvements we've seen clearly translate as well into our ability to meet the demand that we have. The product innovations, we touched on some of those that we have and the impact of those. The Summer-Berry Refreshers, the highest sales we've ever had in a launch week, leading to the Refresher platform reaching 18% of sales, so examples over there. And also the work we're doing with our SR program, an increase in number, an increase in the engagement of these. So those are all the metrics that we have in terms of the kind of improvements that we're seeing against the three-part action plan.

As we look ahead into this quarter and we look at, for example, July, what you see in July is the fact that we are seeing shifts in routines in July. We normally see that from a seasonality perspective, but I think we've seen more pronounced changes in the routines in July. In addition to some of the tech outages that have impacted people across industries. And so we see the disruptions for example at the airport stores that I mentioned or the hospitality stores where we're seeing strong growth.

And so what I would say to you is that our guidance does at the end of the day reflect the challenging consumer environment and what we expect the comps to be, flat to low single digit (sic) [low-single-digit decline] for the year. But what I expect is that these actions that we're putting in place will position us stronger to see growth in FY 2025.

Rachel Marie Ruggeri
Chief Financial Officer and Executive Vice President, Starbucks Corp.

A

And just to remind that comp guidance range is a low-single-digit decline to flat.

Operator: Thank you. And our next question comes from Sharon Zackfia with William Blair. Please state your question.

Sharon Zackfia
Analyst, William Blair & Co. LLC

Q

Hi. Can you hear me now?

Rachel Marie Ruggeri
Chief Financial Officer and Executive Vice President, Starbucks Corp.

A

Yes.

Laxman Narasimhan
Chief Executive Officer & Director, Starbucks Corp.

A

Yes, we can.

Sharon Zackfia
Analyst, William Blair & Co. LLC

Q

Okay. Perfect. That's all like a Verizon commercial. I wanted to ask – I know you gave the kind of returns you're seeing in US new stores as well as in China, but I think with the weakness you're seeing in comps, it kind of begs the question of how committed you are to this kind of global rate of expansion in the 7% to 8% range for company-owned stores.

Laxman Narasimhan
Chief Executive Officer & Director, Starbucks Corp.

A

Well, I'll just make a comment and then hand it to Rachel specifically. So first of all, we're not chasing a number. We look at every project that we have, every site, and we look at the incremental returns, the incrementality of the business that it brings and we're entirely driven by ROI. And we see the strong cash-on-cash returns in the US. Rachel spoke to the kind of cash-on-cash returns we're seeing in the Tier 2 and Tier 3 markets where the headroom is large for us. I mean, we're under-penetrated in those markets. And so if you look at the pipeline of real estate investments in the US, they're really targeted at the Tier 2, Tier 3 mostly, and the work we've done with Deep Brew to identify the sites, to ensure that we build, there's clearly work that's going into how we ensure the returns we get in these sites are strong.

In a very similar way in China, if you look at the cash-on-cash returns that we're getting in the lower tier cities that we're expanding in, the cash returns are strong. So we're not really chasing a number. We're chasing a return. And where we see incrementality, where we see returns, we will invest.

Rachel Marie Ruggeri
Chief Financial Officer and Executive Vice President, Starbucks Corp.

A

The only thing I would add to that is just given the fact that we do see these strong returns and the incremental nature to our overall business, we see the vast opportunity. We have a very rigorous site selection process. We also have the ability to be able to monitor overall performance. And the combination of all of that allows us to strengthen our portfolio through the growth of new stores. So we see it as an important part of our overall long-term growth algorithm. But I think what's important in what Laxman said is it really comes down to ensuring that we keep monitoring the overall economics. And as long as we see the kind of returns we see today, then it supports our long-term growth ambitions.

Operator: Thank you. Your next question comes from John Ivankoe with JPMorgan. Please state your question.

John Ivankoe
Analyst, JPMorgan Securities LLC

Q

Hi. Thank you. We generally have the perception that the US is the leading market for Starbucks around the world and certainly it is in terms of total sales. But my question was, as you look around the world in Latin America or Europe, in Asia, and a lot of markets really are competitive and have challenging consumer environments, what have you, is there anything that you can point to that is being done particularly well in any of these markets from a food, from a service, from a beverage perspective that maybe can be some tangible leading indicators that we can start to get excited about as we think about fiscal 2025 and 2026 innovation past what you've already done? Thank you.

Laxman Narasimhan
Chief Executive Officer & Director, Starbucks Corp.

A

I'll just point to our business in Japan. It's been growing double digits, terrific round of innovation, great execution in stores, strengthened digital presence, and a brand that really celebrates the coffee house in Japan.

I think if you look around the world, we have pockets of these pretty much everywhere. May not necessarily be uniformly the case but pretty much everywhere we have examples of our brand, the experience that we deliver, the products that we bring to bear, the speed of innovation that we have. And by the way even in pockets in China, we have amazing stories of these, in the US too. So I think that there is a broad set of examples that we constantly look at to learn from and find ways of scaling around the world. And that's what we mean at the heart of truly going global, which is our third imperative in our Triple Shot strategy, it is a way for us to share best practices across the world.

Operator: Thank you. And your next question comes from Christine Cho with Goldman Sachs. Please state your question.

Christine Cho
Analyst, Goldman Sachs (Asia) LLC

Q

Yes. Thank you. So you've made some significant investments into staffing, scheduling and partner wage and benefits over the years, and it does seem like it's making very good progress so far. But I was wondering if there were any major areas you see incremental opportunities? And just adding onto that, on one hand you have the goals to improve the cost efficiencies and productivity, but on the other you will continue to focus on partner and customer experience. So just curious to your thoughts as to how you strike a balance here. Thank you.

Laxman Narasimhan
Chief Executive Officer & Director, Starbucks Corp.

A

I feel very good about the progress we are making on delivering a more stable partner experience in our stores in the US. I think, if I just look at the average hours per partner, where we are, it's reached a real high, a historic high. So I feel good about that.

I think part of what we are looking to continue to do is how we ensure we simplify in stores, how we simplify our menus, how we simplify our beverage builds, how we simplify in our supply chain what happens upstream versus downstream and how we focus on training, how we ensure more consistency in the experiences that we deliver and the Siren Craft System is a great example of this. Some of the stories we've heard as we rolled this out over the course of – over the last several weeks including this week across all our network is just what it's doing in the terms of the partner reception and the positivity we hear from partners including what they say about their ability to connect with customers and also deliver a more personable experience in stores.

So it's clearly this is the sort of thing that we have to do and just continue to make the right investments to deliver the right partner experience in order to exceed the customer expectations that I know a premium brand like ours is all about.

Operator: Thank you. The last question comes from David Palmer with Evercore ISI. You may ask your question.

David Palmer
Analyst, Evercore ISI

Q

Thank you. I wanted to go back and look at some of the products and the value strategies from April through July. You were very active with some of the new products and they would be something beyond the coffee core. They would be things that would you think would drive not just the strong trial that you say, but incremental traffic to your business and I know you were going to dial up some value marketing, maybe you confirm if you felt like you did that. But I'm wondering, what do you think worked particularly well, not just in the first trial week or two, but on a more sustaining basis from that in these initiatives including the value and the new products and in light of the traffic decline of 6%, I'm wondering what do you think were really the offsets. Has there been some decline in the coffee core or is there a daypart or how should we think about offsets to these things that you're doing? Thanks very much.

Laxman Narasimhan
Chief Executive Officer & Director, Starbucks Corp.

A

Thank you, David. Let me just first start with coffee, right. I think as I said in my prepared remarks, we've gone to one additional point on cold, so it's now 76. Obviously that's seasonal, but it's 76. If you look at our espresso business, that's grown 4%. So espresso drinks are up 4%. So coffee has grown.

And our distinctiveness is in coffee and I think you'll see that in the kind of innovations and new products we're bringing including the launch of Milano Duetto towards the end of this quarter. So coffee is core to who we are, distinctive in terms of breadth of what we bring and the products will obviously have that.

I think one of the things we did talk about was the fact that afternoons are an opportunity for us and as we look at these new platforms of what we have launched, if I look at Pearls for example, it was significantly ahead of what we thought it would be to the point where we ran out of supply. And I think that it wasn't a supply issue necessarily, but it was more the demand was ahead of what we thought it would be. We had to pull back marketing and my sense is that as you look at what we now have in our stores, they're back in stores with new products and it's a platform that we'll continue to build over time so we're not just launching a product, we're launching platforms. The energy platform, you know, we've been in the energy business since 2007 with the launch of Double Shot and Triple Shot Espresso. What we now have is we have a zero calorie energy platform that we are scaling and it's building steadily and will be something that we're committed to over time.

If you look at some of our food innovations like the egg mozzarella pesto sandwich as an example. It's a terrific sandwich, and again it's one that's going to join our core, but it's building systematically over time. We still have work to do around supply, around how we ensure stability and reliability of supply, particularly in food in order to get the kind of service that we're going to need across our 10,000 stores with the products that we launch so that's an opportunity, David, that I think we still have and the team is working very hard along with our suppliers in order to make that happen.

Operator: Thank you. That was our last question. I will now turn the call over to Laxman Narasimhan for closing remarks. Thank you.

Laxman Narasimhan

Chief Executive Officer & Director, Starbucks Corp.

Thank you all for time today. If you take away one thing, let it be this. We're making real progress on our three part plan. We are focused on what we can control in a consumer environment that can be best be described as complex. Our teams are moving with urgency. I thank them for their efforts and for staying focused on what we can control. I have full confidence in the long-term potential of Starbucks worldwide. Thank you.

Operator: Thank you. This concludes Starbucks third quarter fiscal year 2024 conference call. You may now disconnect.