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BBY.N - Q3 2022 Best Buy Co Inc Earnings Call

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by. Welcome to the Best Buy's Q3 FY 2022 Earnings Conference Call. (Operator Instructions) As a reminder, this call is being recorded for playback and will be available by approximately 11 a.m. Eastern Time today. (Operator Instructions)

I will now turn the conference over to Mollie O'Brien, Vice President of Investor Relations.

Mollie O'Brien - *Best Buy Co., Inc. - VP of IR*

Thank you, and good morning, everyone. Joining me on the call today are Corie Barry, our CEO; and Matt Bilunas, our CFO.

During the call today, we will be discussing both GAAP and non-GAAP financial measures. A reconciliation of these non-GAAP financial measures to the most directly comparable GAAP financial measures and an explanation of why these non-GAAP financial measures are useful can be found in this morning's earnings release, which is available on our website, investors.bestbuy.com.

Some of the statements we will make today are considered forward-looking within the meaning of the Private Securities Litigation Reform Act of 1995. These statements may address the financial condition, business initiatives, growth plans, investments, and expected performance of the company and are subject to risks and uncertainties that could cause actual results to differ materially from such forward-looking statements. Please refer to the company's current earnings release and our most recent 10-K and subsequent 10-Qs for more information on these risks and uncertainties. The company undertakes no obligation to update or revise any forward-looking statements to reflect events or circumstances that may arise after the date of this call.

I will now turn the call over to Corie.

Corie Sue Barry - Best Buy Co., Inc. - CEO & Director

Good morning, everyone, and thank you for joining us. Today, we are reporting record Q3 financial results of \$11.9 billion in sales and non-GAAP diluted earnings per share of \$2.08, which is up 1% over last year and up 84% compared to 2 years ago.

Against a still of all the backdrop, our leaders continue to drive new ways of operating, and our employees continue to do amazing things to support our customers' technology needs in knowledgeable, fast and convenient ways. Our omnichannel capabilities and our ability to inspire and support across all of technology in a way no one else can means we are uniquely positioned to seize the opportunity in this environment and in the future.

We continue to capitalize on strong customer demand as more people sustainably work, entertain, cook and connect at home. And Domestic comparable sales growth was up 2% on top of 23% last year. From a merchandising perspective, the biggest contributors to our comparable sales growth in the quarter were appliances, home theater and mobile phones.

Product availability continued to improve throughout the quarter. We have pockets of constraints in areas like appliances, gaming and mobile phones. Similar to last quarter, however, we do not believe this materially limited our overall sales growth. While we have faced and continue to face supply chain challenges, including delays and higher costs, we are proactively navigating a situation that we have been dealing with for several quarters as our industry has been facing disruptions and supply constraints since early in the pandemic.

Our merchant demand planning and supply chain teams made strategic sourcing and inventory decisions early in the year to set us up well heading into holiday. And we are resourcefully adapting to the constantly evolving environment with actions like pulling up product flow, adjusting store assortment based on availability and acquiring additional alternative transportation. We have deep, long-standing relationships with our transportation and logistics vendors, and they have been incredibly supportive as we navigate.

In addition, through our close partnerships with our product vendors, we have a great deal of visibility into and can influence the status of product in the supply chain process. We have varying degrees of inventory and supply chain challenges every holiday season, and this year will be no different, but we entered Q4 with 15% more inventory year-over-year and feel confident in our ability to serve our customers throughout the holiday.

As expected, we did experience a more promotional environment for many of our products when compared to last year. When compared to 2 years ago, we still saw a less promotional environment during Q3. From a sales channel perspective, results were similar to last quarter. Customers are returning to stores and they are also choosing to interact with us digitally and via phone and chat at much higher rates than pre-pandemic.

Online sales were 31% of Domestic revenue compared to 16% in Q3 of fiscal '20, growing by more than \$2 billion during that time. Our app saw 19% increase in unique visitors versus last year, and phone and chat sales continued to climb versus last year and 2 years ago.

We continue to be an industry leader in fast and convenient product fulfillment for our customers. During the third quarter, we reached our fastest small product delivery times ever. Compared to last year, same-day delivery was up 400% and we nearly doubled the percent of products delivered within 1 day. Based on a third-party analysis of competitor websites, we are the leader in 1 day or less published shipping time across a sample of higher-volume ZIP codes and higher demand items.

In addition to partnering with a diversified set of delivery partners, we also thoughtfully used our employee delivery capability as we now have more than 400 stores doing employee deliveries, with almost 60% of our customers living within 10 miles of an employee delivery location. We also have an industry-leading in-store pickup experience. We have, by far, the broadest assortment of CE products available for pickup, and the process is incredibly fast.

In Q3, more than 90% of online orders that were available for product pickup were ready in less than 30 minutes of the order being placed. Customers clearly find value in coming to our stores to pick up their products as the percent of online sales picked up at our stores remained high at 42%, even with our fast home delivery options, with 1/3 of our store pickup customers choosing our convenient curbside option. And our customer NPS for order pickup in Q3 was up versus last year and 2 years ago. In fact, in the last year, 31% of all our purchasing customers bought online and picked up in store at least once.

These strong Q3 results and our market-leading omnichannel capabilities are due to our amazing associates across the company and the investment decisions we have made in the last several years in supply chain, store operations, our people, and technology. Clearly, our business has changed dramatically in the last 2 years, with digital sales more than double pre-pandemic levels and phone, chat, and in-home sales growing. Customers are starting their research and shopping online and then branching out from there to all forms of digital and physical shopping depending on their specific needs.

Stores are crucial to our customer experience, and they need to be even more efficient and must keep pace with greater customer expectations. For example, we know customers sometimes seek out in-person help to answer questions, and other times, they would rather use digital tools to learn about products or pick up their orders in our stores.

We have made the right investment decisions to position us as a leader in omnichannel retailing. While we are proud of our progress, there are even more opportunities ahead of us, and it is more important than ever to build on our position of strength and truly become a customer-obsessed company. This means we put the customer at the heart of all we do by anticipating their needs, listening, learning and applying those insights to create long-term relationships and seamless experiences. That led us to launch Best Buy Totaltech last month.

Totaltech is a bold new membership program, leveraging our strengths across merchandising, fulfillment, installation, tech support, and product repair, unique capabilities that customers value and no one else can match. Our membership program offers product discounts and periodic access to hard-to-get inventory, free delivery and installation, free technical support, free product protection and many other benefits.

Let me provide a tangible example of how the offer can come to life. A Totaltech member purchases a 65-inch TV and gets a \$150 member discount. She gets the TV delivered and mounted on the wall in her living room. The next month, she buys a new iPhone for her daughter. As long as she keeps up her membership, she gets 2 years of product protection on the TV she bought and 2 years of AppleCare+ protection for the phone.

A few weeks later, she can't get her laptop to connect to her printer. So she hops on the dedicated chat line with Geek Squad who fixes the problem by remoting into her computer, so she can get on with a productive day of working from home. As a member, she received all those benefits for \$199 per year. As you can see, not only do members receive significant savings, they can also be confident that whatever their technology needs are, we will be there to help.

The goal is to create an experience that makes it inconceivable for members to purchase their tech from anyone else, driving a larger share of consumer electronic spend to Best Buy. We successfully rolled out the program nationally and online and converted more than 3 million former tech support members. It is very early as we just launched last month. But so far, we continue to see behaviors that we intend to drive and that we saw in the pilot, including more frequent interaction and higher incremental spend than nonmembers.

Given the breadth of the offer, it is resonating well across all customer demographics and our new members are skewing younger than our former Total Tech Support membership program. NPS numbers across all channels are higher than for nonmembers as well. And importantly, our employees believe in and love articulating the value of membership to our customers.

As we discussed in previous calls, we are in the midst of multiple store pilots and tests. Of course, we are always piloting concepts. But right now, we are very focused on piloting and testing to build a framework that will move us from a retailer that is focused foremost on its stores to a true omnichannel one that provides equal focus on all the ways customers shop with us.

I will provide a few updates on our progress. We launched Phase 1 of our virtual store pilot last month. For this, we built out a physical store in one of our distribution centers with merchandising and products that is staffed with dedicated associates, including vendor-provided expert labor. It has no physical customers. Instead, customers interact with our experts via chat, audio, video and screen sharing depending on their preference and are able to see live demos, displays and physical products.

It is early, and we have not rolled out all the product categories yet, but initial results are showing much higher conversion rates as well as higher average order value than we see with historical chat interactions.

In Charlotte, we have made significant progress rolling out the market pilot designed to leverage all our assets in a portfolio strategy across stores, fulfillment services and outlet lockers, our digital app and both in-store and in-home consultation labor. We launched our new outlet featuring all product categories in addition to a new services hub model and remodeled 8 stores. And in Houston, we are continuing to see strong results from our experiential store pilot and plan to roll out aspects of this more broadly in stores across the country as we enter next year.

These are not the only pilots happening, and thus, they aren't the only pilots that will influence where we go as a company. From Northern California to Houston to The Bronx, we are assessing new formats and learning our way to the right physical model. At the same time, we are piloting and evolving our labor models in other markets to meet our customers' changing shopping behaviors. That means leveraging technology in stores that don't have as much labor and developing a much more flexible workforce.

This is a workforce that can not only provide expert help across product categories, both in-store and virtually, but also flex into other activities like curbside fulfillment, and it empowers employees to flexibly pick up shifts at other stores or at our distribution centers.

I also want to highlight our unique ability to both inspire and support our customers through our consultation and our Geek Squad services. We have almost 3,000 consultants and designers to provide free consultations across customers' homes, in stores and virtually. These consultations represent one of our highest NPS experiences consistently over 80. Importantly, they also lead to longer-term and stickier customer relationships as more than 85% of customers who use the program stated they intend to continue shopping with their consultants.

Turning to the product support we provide, as many of you likely know, when something goes wrong with your products or delivery or installation, it is a highly unplanned and often emotional event. Not surprisingly, our customer research tells us that customers value quick response times and demand transparency, fast repair times, and quality repairs from a trusted provider. Our Geek Squad has an industry-leading set of capabilities that garner market-leading NPS and also drive additional revenue for Best Buy in the moment and over time.

Around 20% of our phone and computer repair customers purchase additional products the day they receive the repair. Additionally, our data shows that customers who have phone or computer repairs are far more likely to make a purchase in the following 12 months. Over time, we have also been evolving our partnerships with our vendors in response to changing customer shopping behavior.

Our in-store vendor experiences are crucial to our customer experience and remain a significant source of competitive advantage. We have extended many of these in-store experiences to digital experiences. Our vendors partner with us to provide expert training and tools for our consultants and designers. And importantly, our vendors are increasingly sending sales leads from their own websites to our consultants and designers.

We are also leveraging our unique Geek Squad capabilities to strengthen and expand our partnerships with our vendors. We are already the nation's largest physical destination for Apple authorized repair services, including same-day iPhone repairs, attracting new customers as 1/3 of these Apple repair customers are new or reengaged customers for Best Buy.

In October, we launched Samsung authorized phone repair service nationally. Roughly 30% of our stores will offer same-day in-store repairs completed by Samsung certified Geek Squad agents, using Samsung parts, diagnostics and tools. Phone repair is a universal need for customers, and this expansion gives Best Buy the capability to repair the overwhelming majority of phones in the marketplace.

In addition, we are also starting to leverage our industry-leading and convenient buy online, pick up in store experience in partnerships with our vendors. Customers purchasing select items on [samsung.com](https://www.samsung.com) now have the option to pick up their products at their local Best Buy store and shoppers purchasing Insignia, Toshiba and Pioneer Fire TVs on [amazon.com](https://www.amazon.com) can pick up their TVs at their local Best Buy stores.

For many of our vendors, we use our considerable supply chain expertise to transport their product often from the country of origin to our distribution centers. In addition to helping our vendors, it allows us to increase our level of visibility into incoming inventory and to garner greater scale.

And finally, we have been investing in our long-standing advertising business, building new capabilities to help vendors effectively reach our customers. Best Buy's relevance, customer relationship, and first-party data have grown along with customers' technology needs and our ability to meet those needs. These are all great examples of value we can provide to our vendor partners that many other retailers cannot.

In addition to focusing our performance on our core CE and appliance categories, we are continuing to expand our assortment in newer categories where we can leverage our ability to commercialize new technology. For example, we created a robust online experience and assortment for electric transportation. And during Q3, our sales in the category more than doubled. As a result, we are expanding our online assortment of electric bikes by 4x and also plan to assort them in physical stores early next year.

And because customers are looking to us to complete their solutions, we have been expanding our assortment in categories like outdoor living, as more and more consumers look to make over or upgrade their outdoor living spaces. This includes products like patio furniture, grills, fire pits, and electric mowers, just to name a few. In fact, earlier this month, we acquired Yardbird, a leading direct-to-consumer company that specializes in premium sustainable outdoor furniture, including dining sets, lounge seating, fire tables and accessories. We are excited about the opportunity to use our expertise in merchandising and supply chain to scale this business both online and in physical locations across the nation.

We also made an exciting acquisition recently in the health space. Let me take a second to reiterate our overall health strategy and how the acquisition fits. Our Best Buy Health strategy focuses on 3 areas that start with our strength in retail and build to connecting patients to physicians. The first focus area is the consumer health category for customers who want to be healthier, sleep better, or need to monitor a chronic condition like diabetes or heart disease, for example. You can see this built out in a robust way on our website.

The second area is active aging, which includes device-based emergency response and other services for Generation A, who wish to live independently in their homes. This opportunity shows up prominently in our physical stores. The third focus area is virtual care. Best Buy's role in virtual care is to enable people in their homes to connect seamlessly with their health care providers. The trend to this type of care is increasing, accelerated in large measure by the pandemic.

To more fully meet that growing customer demand and accelerate our work with new and innovative services, we acquired a company called Current Health. Current Health developed a market-leading remote patient monitoring platform that allows physicians to monitor and connect with patients in their home. Their platform includes an FDA-cleared wearable medical device that monitors vital signs, a home hub, which integrates to hundreds of other monitoring devices, and integration to the patient's electronic health record.

With their remote monitoring platform, combined with the scale, expertise and connection to the home that Best Buy has, we will be able to create a holistic care ecosystem that shows up for customers across all their health care needs. To be clear, even though the health care industry is evolving quickly, in many ways as a result of the pandemic impacts, it adopts new ways of doing things at a much slower pace than other industries like retail. Virtual care is a truly nascent space with significant opportunity, but it will take time and investment to develop our offerings and scale.

As you can see, technology developments are driving our initiatives across the company. We need technology tools and capabilities to help us as we transform and evolve the way we operate and serve our customers. That is why we continue to devote significant resources to technology investments. For example, we are leveraging our investments in electronic sign labels to very nimbly highlight Best Buy Totaltech member pricing for customers shopping in our stores. We also just launched the ability for our electronic sign labels to provide important messaging regarding product availability, so that customers will easily be able to see if the product is in stock in that store or at another store nearby or when it could be delivered and installed.

Technology was instrumental in recently launching the first of many new communication enhancements to improve our award-winning appliance customer experience. Metro delivery customers, that utilize the appointment tracker page on the day of their delivery, can now see how many stops away their driver is at any given time. It may seem like a small enhancement, but already, we can see significant customer engagement with the page. Another step toward our goal to make customers feel confident and in control throughout the research, purchase, fulfillment and use of their large product.

Technology was also crucial in our recent launching of next-day delivery of appliances and large TVs, which we are piloting first for in-store and online customers in our Minneapolis and Baltimore markets. Next month, we are launching a new capability, leveraging QR codes for high-velocity products that are locked up, particularly in areas of high shrink. Instead of waiting for an associate to unlock the product, the customer can scan the QR code and then proceed to check out to pay and pick up the product. And we recently implemented enhancements to our digital platform,

improving flexibility across our workforce by seamlessly giving employees the ability to pick up open shifts at nearby locations in addition to their home location.

These examples are a small token of the work our digital and technology teams are doing to improve the customer and employee experience. And of course, we are also continuing to make significant investments in fundamental technology capabilities like data and analytics, and broader cloud migration in order to drive scale, efficiency and effectiveness.

I would like to take a moment to extend my gratitude to our people. Over the past 21 months, they have flexibly dealt with rapidly changing store operations as we responded to impacts of the pandemic. They created safe environments for customers and worked tirelessly to provide excellent service, even in situations where customers resisted following safety guidelines and in some cases were disrespectful.

In addition, we have increased the level of pilots and tests in the field as we evolve our operating model. This has introduced a great deal of change. We know that change is exciting, but we acknowledge it can also be challenging. I am truly grateful for and impressed by our associates' dedication, resourcefulness and flat-out determination. And I'm thrilled to say that our in-store NPS in Q3 increased versus last year and versus 2 years ago before the pandemic despite all of these disruptions.

Now I would like to briefly touch on our ESG efforts and how we are working across the company to have a positive impact on our planet. Earlier this month, we announced that we are a founding member of the Race to Zero initiative that aims to accelerate climate action within the retail industry. Best Buy's participation builds on our existing efforts to reduce our carbon footprint. We are proud of our progress in reducing emissions 61% since 2009, and we have pledged to be carbon neutral by 2040.

We have also taken on a more specific focus on the circular economy within our operations and with our customers. In Q3, we collected and responsibly recycled more than 48 million pounds of consumer electronics, keeping products and commodities out of landfills. To help our customers live more sustainably, last quarter, we sold more than 5 million ENERGY STAR certified products, helping our customers reduce their carbon footprint and save on utility bills.

We also kept more than 600,000 devices in use longer and out of landfills by leveraging our customer trade-in program, Geek squad repair services and Best Buy outlets. These are initiatives our customers and vendors value and capabilities no one else has at our scale and breadth.

In summary, we have delivered remarkable year-to-date results, and I am so proud of the execution of all our teams. We are looking forward to a strong holiday season and believe we are extremely well positioned with both the tech customers wants and fast and convenient ways to get it. We launched some of our Black Friday deals in mid-October that included a price guarantee for all customers. And this past Friday, started Black Friday early by making almost all of our Black Friday deals available.

Throughout the holiday season, we are promising free next-day delivery on thousands of items. And of course, store pickup, whether in-store or curbside, will be a great and convenient option for our customers to get their products.

Building on that, as we think about next year and beyond, we are mindful of just how much the consumer has changed and how enduring that change will be. Terms like home nesting and virtual care have been invented to describe what all of us know so well, that where we work, entertain, receive health care, and connect has changed, and our homes are now central to our lives more than ever before. The penetration of technology associated with this way of living has been and continues to be sizable. And we are already seeing shorter upgrade cycles as technology evolves and we constantly optimize our homes.

The demand for convenience and experience on the customers' terms has exponentially driven change. Our hypothesis has consistently been that true omnichannel retailing would create differentiated experiences that allow us to seamlessly and conveniently engage and retain customers. As such, we have continuously invested in these experiences and notably, we never defined omnichannel as being stores and online. Instead, we included our unique and powerful service, virtual and in-home capabilities.

We are certain that technology will continue to play a more dominant role in consumers' lives. Given our omnichannel capabilities, the ones we have today and the ones we are building for the future, we are fully confident that we will capitalize on a much larger, more broadly defined consumer electronics category and be able to better serve a customer who will be using and upgrading much of that CE more frequently.

We plan to hold an investor event next March to share more detail on our initiatives, provide our thoughts on our financial model going forward and introduce longer-term financial targets. I will now turn the call over to Matt for more color on our financial results.

Matthew M. Bilunas - *Best Buy Co., Inc. - CFO*

Good morning, everyone. We are once again reporting strong financial results that continue to support our belief that technology plays an even more important role in everyone's lives, and we are uniquely positioned to serve them.

Despite lapping the extraordinary 23% comparable sales growth from last year, we were once again able to generate positive comparable sales growth in each fiscal month of the third quarter.

Compared to our guidance, Enterprise revenue of \$11.9 billion exceeded the high end of our revenue outlook of \$11.6 billion, driven by the better-than-expected comparable sales growth of 1.6%. Our non-GAAP gross profit rate and SG&A expense were essentially in line with our expectations.

Compared to last year, Enterprise revenue grew \$57 million, and our non-GAAP diluted earnings per share of \$2.08 increased \$0.02. A lower share count resulted in a \$0.12 per share benefit on a year-over-year basis. Our non-GAAP operating income rate of 5.8% decreased 30 basis points as we invested in the launch of our new Totaltech membership.

When comparing our results against 2 years ago for the third quarter of our fiscal '20, total revenue grew more than 20%. Additionally, our Domestic store channel revenue was approximately flat versus 2 years ago, while online revenue grew almost 150% in that time frame. As a result of the higher revenue and our ability to adjust to a new customer shopping behavior, our enterprise non-GAAP operating income rate was 160 basis points higher this quarter than the comparable quarter from 2 years ago.

Let me now share more details specific to our third quarter. In our Domestic segment, revenue increased 1.2% to almost \$11 billion. This increase was driven by a comparable sales increase of 2%, which was partially offset by the loss of revenue from store closures in the past year. As Corie shared, the biggest contributors to the comp sales growth in the quarter were appliances, home theater and mobile phones.

After delivering significant growth for the past several quarters and lapping a 46% comp in the third quarter of last year, computing comparable sales were down slightly on a year-over-year basis, but still up nearly \$1 billion from 2 years ago. In addition, our services comparable sales declined 5.6% this quarter. This was primarily the result of our new Totaltech membership, which includes benefits that were previously stand-alone revenue-generating services such as warranty and installation.

In our International segment, revenue decreased 7.8% to \$925 million. This decrease was driven by the loss of approximately \$90 million in revenue from exiting Mexico and a comparable sales decline of 3% in Canada. Partially offsetting these items was the benefit of approximately 450 basis points from foreign currency.

Turning now to gross profit. The domestic gross profit rate decreased 60 basis points to 23.4%. As expected, the decrease was due to, one, lower profit margin rates, which were primarily driven by lapping lower levels of promotions, product damages and returns compared to last year as well as higher inventory shrink; and, two, lower services margin rates, which included rate pressure from Totaltech. The previous items were partially offset by higher profit sharing revenue from the company's private label and co-branded credit card arrangement.

The gross profit rate pressure from our new membership offering primarily relates to the incremental customer benefits and associated costs compared to our previous Total Tech Support offer. As Corie mentioned, like many others, we saw increased transportation costs within our supply chain. However, this pressure was offset by reduced parcel expense since our mix of online sales was lower than last year.

The International non-GAAP gross profit rate increased 240 basis points to 25%. The higher gross profit rate was driven by improved product margin rates in Canada and a loss of lower-margin sales from the Mexico exit.

Moving next to SG&A. Domestic non-GAAP SG&A increased \$9 million and improved 20 basis points versus last year as a percentage of revenue. As expected, higher advertising expense and increased technology investments were partially offset by last year's \$40 million donation to the Best Buy Foundation and lower incentive compensation.

When comparing to 2 years ago, Domestic non-GAAP SG&A increased \$155 million and decreased 230 basis points as a percentage of revenue. The largest drivers of the increase versus fiscal '20 were higher incentive compensation, increased technology and advertising investments and additional variable costs due to the higher sales volume. Partially offsetting these items was lower store payroll expense.

Moving to the balance sheet. We ended the quarter with \$3.5 billion in cash. At the end of Q3, our inventory balance was 15% higher than last year's comparable period and was 13% higher than our Q3 ending inventory balance from 2 years ago. The increased inventory represents our plans to support the current demand for technology as well as last year's unusually low inventory balance.

Earlier this month, we completed our acquisitions of Current Health and Yardbird, which will be reflected on our cash flow statement in Q4. The combined purchase price of the 2 transactions was approximately \$485 million and they were funded with cash. The Current Health acquisition was a larger cash outlay at approximately \$400 million and is expected to have a slightly negative impact on our Q4 non-GAAP operating income. We are not expecting either acquisition to have a material impact on our revenue performance this year.

During the quarter, we returned a total of \$577 million to shareholders through share repurchases of \$405 million and dividends of \$172 million. With a year-to-date share buyback spend of \$1.7 billion, we still expect to spend more than \$2.5 billion in share repurchases this year.

Let me next share more color on our guidance for the fourth quarter, which remains very similar to the implied guidance we provided last quarter. We expect comparable sales growth to be in the range of down 2% to up 1% to last year, which is on top of our 12.6% comparable sales growth in the fourth quarter of last year. Like other companies, we continue to monitor the evolving impacts of the pandemic and supply chain pressures driven by global demand. We are confident in our ability to navigate the ever-changing environment. From a profit rate perspective, we are planning for a non-GAAP rate that is approximately 30 basis points below last year's rate due to the estimated impact of our new Totaltech offer, which we expect to be partially offset by a more favorable product mix.

From a non-GAAP SG&A standpoint, we are planning dollars to increase approximately 8% compared to last year. The largest drivers of SG&A increase are expected to be technology investments, increased advertising, health investments, and higher compensation, in addition, incentive compensation. In addition, we are planning on increased spend compared to our previous outlook for store labor and call center support this holiday season to better support the customer experience.

Turning to our full year outlook. We expect the following: Enterprise revenue in the range of \$51.8 billion to \$52.3 billion compared to our previous guide of \$51 billion to \$52 billion. Comparable sales growth of 10.5% to 11.5% compared to our previous guide of 9% to 11%, and a non-GAAP gross profit rate slightly higher than last year. For SG&A, we expect growth of approximately 9.5%, which compares to our prior outlook of 9%. We expect our non-GAAP effective tax rate to be approximately 20%, and we expect capital expenditures to be in the range of \$800 million to \$850 million.

I will now turn the call over to the operators for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Anthony Chukumba with Loop Capital Markets.

Anthony Chinonye Chukumba - *Loop Capital Markets LLC, Research Division - MD*

Congrats on a great quarter, particularly your ability to comp the comp against that really tough comparison year-over-year. So having said all that, one thing that just struck me a little bit was that you called out shrink as a gross margin headwind. I was just wondering if you can just provide a little bit more color around that?

Corie Sue Barry - *Best Buy Co., Inc. - CEO & Director*

Yes, absolutely, Anthony. I think you've probably seen in the media that across retail, we are definitely seeing more and more, particularly, organized retail crime and incidence of shrink in our locations. And I think you've heard other retailers talk about it and we certainly have seen it as well. I want to start with, our priority has always been and will remain the safety of our people, whether that's the pandemic, whether that is unruly customers, whether that is outright theft, which is a great deal of what we're seeing right now. And this is a real issue that hurts and scares real people.

We are doing a number of things to protect our people and our customers. As we talked about in the prepared remarks, we are finding ways where we can lock up product, but still make that a good customer experience. In some instances, we're hiring security. We're working with our vendors on creative ways we can stage the product. We're working with trade organizations. But you can see that pressure in our financials. And more importantly, frankly, you can see that pressure with our associates. This is traumatizing for our associates and is unacceptable. We are doing everything we can to try to create as safe as possible environments.

Anthony Chinonye Chukumba - *Loop Capital Markets LLC, Research Division - MD*

Got it. Good luck with the holiday selling season.

Corie Sue Barry - *Best Buy Co., Inc. - CEO & Director*

Thank you, Anthony.

Operator

Our next question comes from Simeon Gutman with Morgan Stanley.

Hannah M. Pittock - *Morgan Stanley, Research Division - Research Associate*

This is actually Hannah Pittock on for Simeon Gutman. I wanted to ask on your Q4 guide. On the top line, it implies a pretty big deceleration on the comp stack. Are you seeing a slowdown in demand? Was there some pull forward do you think in holiday purchasing into Q3? Or is there maybe some conservatism built in there? Any detail you can give?

Matthew M. Bilunas - *Best Buy Co., Inc. - CFO*

Sure. I'll take that. This is Matt. We're projecting Q4 comps to be up 1% to down 2% compared to last year. The guidance range we actually gave is slightly up from the implied guidance range from last quarter. As a reminder, in August, we materially raised our sales guidance for the back half of the year from the expectations we had that we started the year. We still feel really confident about our inventory levels and our positioning for the holiday. And so I'd say, Q4 is a little more unique of a period of time, a place where our category is leveraged by many retailers over the holiday gifting season.

I would also say that some sales probably got pulled into October similar to last year as a lot of the narrative in the media in supply chain constraints worried our consumers. So during the first 3 weeks of last year as well, the gaming consoles released, which provided a bit of a lift. And we're also very mindful of lapping the stimulus dollars that came in January. As we talked about last year, we saw strong results in October, the sales moderated, and they started to pick back up in January.

The last thing I'd say about Q4 is Super Bowl. Actually, majority of the business is shifting into Q1 of next year. We're starting the November about flattish sales. So we're still encouraged by the holiday demand that the consumer is very strong still. And so we're excited and think we're well positioned.

Hannah M. Pittock - *Morgan Stanley, Research Division - Research Associate*

That's very helpful. Maybe a quick follow-up just on your domestic versus International segment. Obviously, Domestic kind of decelerated sequentially, and International actually picked up. In Q4, can you tell us anything about kind of the relative contribution you expect?

Matthew M. Bilunas - *Best Buy Co., Inc. - CFO*

I would expect that contribution to be relatively the same in Q3. Our International business on a 2-year basis was pretty similar to the U.S. They actually did stronger sales in Q3 last year than the Domestic business. So relative to the U.S., pretty consistent. And a lot of the same drivers for the U.S. business are similar internationally as well.

Operator

Our next question comes from Christopher Horvers with JPMorgan.

Christopher Michael Horvers - *JPMorgan Chase & Co, Research Division - Senior Analyst*

So I guess focusing a little bit on the gross margin and the adoption of Totaltech. Just curious on that impact in the third quarter, and as you think about the fourth quarter, down 30 basis points expected, so the Totaltech is a number than that. I was just curious how much of that is sort of diminishment of warranty sales versus more of an accounting phenomenon that you're sort of recognizing the benefit of Totaltech over an extended period of time versus prior?

Matthew M. Bilunas - *Best Buy Co., Inc. - CFO*

Yes, the Totaltech impact essentially is due to just the enhanced benefits for that offering versus the Total Tech Support offering as we talked about last quarter. It's really that additional benefit that drives more short-term pressure on the gross margin rate. There is a little bit of revenue recognition difference between Total Tech Support and Totaltech. Total Tech Support a bit more was recognized in the first couple of months. Totaltech is more spread out across the entire year, so more of that pressure is coming from that.

But I'd also note that the goal of Totaltech is to actually drive more sales and drive more product sales and that will take a little bit of time as we start to ramp up the program. So that will help offset some of the pressure you see from the cannibalization of the services business.

Christopher Michael Horvers - *JPMorgan Chase & Co, Research Division - Senior Analyst*

And just as a quick follow-up on the last question. Do you have a sense or an estimate of perhaps how much January actually benefited from stimulus as we think about the sequencing of the current quarter?

Matthew M. Bilunas - *Best Buy Co., Inc. - CFO*

Yes. I mean, we said all of last year that stimulus is really hard to break out. It certainly did have a benefit. We could see the business change in January from the previous months. So we know it did have an impact. It's really hard to break out specifically.

Christopher Michael Horvers - *JPMorgan Chase & Co, Research Division - Senior Analyst*

Got it. Understood. Have a great holiday season.

Matthew M. Bilunas - *Best Buy Co., Inc. - CFO*

Thank you.

Operator

Our next question comes from Liz Suzuki with Bank of America.

Elizabeth Lane Suzuki - *BofA Securities, Research Division - VP*

Great. So there are some other big box retailers that have gotten more invested in helping customers age in place, which you talked about in the prepared remarks. Clearly, there's a bigger focus on technology and Connected Health at Best Buy. How are you working on increasing customer awareness? Like what does the marketing look like for this particular initiative?

Corie Sue Barry - *Best Buy Co., Inc. - CEO & Director*

Yes. Thanks for the question, Liz. We have been really focused on this idea that tech could be instrumental in helping people age more comfortably in their homes for quite a while. It started with our purchase of a GreatCall a few years ago. And part of the reason that we brought GreatCall on board is they had massive experience in dealing with an aging population. And specifically to your question, targeting the right messages to the right people, which is not just targeting the aging population, it's also targeting caregivers who may be looking for some of this product.

And so you've seen us over time, we established a relationship with AARP back in March of 2020 as one of our venues. We have a lot of actually, in this space, direct mail and direct targeting because for the populations that we're looking at here, those are some of the most effective means that we have. And then over time, I think you're going to see some of our more broad-based Best Buy messaging, really pointing to the fact that we have a variety of solutions that can help people age in their homes. It's not always just the devices and the care wrappers. Sometimes it's things like a Facebook portal where you can connect with someone on the other side really simply and easily, or a device, a camera and a security system, where I can easily lock my door without having to get up or I can keep an eye on that aging loved one.

And I think already, you've seen and will continue to see us run the gamut of both these very targeted messages to the population that we really want to inform all the way to these kind of more broad-based solution-driven messages about what we could help you do to care for a loved one.

Elizabeth Lane Suzuki - *BofA Securities, Research Division - VP*

Great. And just a follow-up on how Totaltech could potentially play into that? And if there are any key performance indicators you can highlight that you're looking at on total effect as you track the opportunity there?

Corie Sue Barry - *Best Buy Co., Inc. - CEO & Director*

Well, what's interesting about Totaltech in the aging in place scenario is that, it is more important than ever that your technology works for you if you're relying on it for your safety, or if you're a caregiver, if you're relying on it for the safety of others. And so the support wrapper around all of the things that we're talking about in health is incredibly important. And it also will help, obviously, this population, whether it's the caregiver again or the person being cared for, add more devices, feel comfortable adding devices; we can go to your home and help you install those, and then we can keep them up and running. And I think that's really important.

In terms of the KPIs that we look at, it's really across Totaltech. We're looking for things like increased frequency of interactions. And that may be everything from browsing on the website all the way to coming in the store and making an actual purchase. We're looking for stickiness of that consumer, meaning they're more willing to come back Best Buy, bigger share of wallet, more purchase behavior with Best Buy over the longer term. And that will be true whether we're talking about aging in place or whether we're talking about the other aspects of Totaltech. And then obviously, we're going to look for customer satisfaction and engagement with the brand and really trying to almost surprise and delight and overdeliver wherever we can for these paying members.

Operator

Our next question comes from Brian Nagel with Oppenheimer.

Brian William Nagel - *Oppenheimer & Co. Inc., Research Division - MD & Senior Analyst*

Nice quarter, congrats.

Corie Sue Barry - *Best Buy Co., Inc. - CEO & Director*

Thank you.

Brian William Nagel - *Oppenheimer & Co. Inc., Research Division - MD & Senior Analyst*

So the question I have, just with regard to promotions. So you called out here in the third quarter, higher promotions is somewhat of a headwind to gross margins. But you also made the point that the promotional activity is still more subdued than it was pre-pandemic. And then I don't think you gave the guidance for Q4 within the down 30 basis points in gross margin, I think there was a mention promotion.

So the question I have is, as you look at what's happening out with promotions, maybe some more color on -- greater color on kind of who or what's driving these promotions. And then where do you think we're going? Are we heading back to pre-pandemic levels or do you foresee promotional activity remaining more subdued as we go forward?

Matthew M. Bilunas - *Best Buy Co., Inc. - CFO*

Brian. Yes, I think in Q3, we've talked about how we expected promotionality to increase, and we certainly saw that, especially in places where inventory is starting to become a little more freeing up and notably in computing. We didn't call it out in Q4, and Q4 product margin rates are expected to be a little bit better, more from a product mix, mixing out of things, gaming consoles and computing. At this point, promotionality, we don't necessarily see it as a good guy or a bad guy in Q4. As you would imagine, Q4 is very promotional and competitive every year. So last year, we were very focused on that as well. This year, we will continue to look at it. But we don't expect it on a yearly basis to be necessarily more or less promotional.

Now against 2 years ago, certainly, we would expect it to be a little less promotional than we saw 2 years ago. Where it heads is something that we're going to have to monitor. That's one of the kind of still things that we're evaluating for next year. Clearly, as inventory becomes more free, you can imagine that promotionality is going to start to increase in categories more one at a time as we get into next year. And so likely starting the year with a little bit more promotionality. But we're not really guiding next year, but I would expect that to start to turn over the next number of quarters.

Brian William Nagel - *Oppenheimer & Co. Inc., Research Division - MD & Senior Analyst*

That's very helpful. A second quick follow-up, if I could. Just with regard to -- so appliance is a key sales driver here in Q3. Lot of talk about higher prices in appliances. So the question I have is, to what extent was inflation in that category actually an incremental sales driver for you?

Matthew M. Bilunas - *Best Buy Co., Inc. - CFO*

Yes. Specifically to appliances, that is one of the areas where it's been pretty well noted that prices have gone up. And that's probably an area where, in most cases, we've flowed those prices on to the consumer. So those sales prices have increased. That's not to say that, that happens in all circumstances and a lot of categories where you still want to make sure you're very competitive with our pricing, even if costs do go up, you're actually being thoughtful about serving them in the best way possible.

I think generally, as you look at our ASPs, the inflation or cost of those goods going up is still a smaller part of what we would see as ASP increases right now. Still the bigger part of the ASP increases would be just premium mix of our business right now versus the inflation estimate. So it is a little higher generally overall than we saw in the first half of the year, but still not the biggest impact to ASPs.

Corie Sue Barry - *Best Buy Co., Inc. - CEO & Director*

And Brian, I think this is why in this space, we continue to really invest in the experience, because our ability to deliver on some of those more premium items in the assortment is really distinctive and different. And this is a great example of the investment and the experience is not just for today, but it's so that we continue to represent the premium side of the business over the longer term.

Operator

Our next question comes from Greg Melich with Evercore ISI.

Gregory Scott Melich - *Evercore ISI Institutional Equities, Research Division - Senior MD*

I had a 2-part question. One was, I wanted to understand a little bit more about the SG&A dollar growth in the fourth quarter. How much of that is due to the acquisitions or the particular membership investment? And how much of that is just the inflation or normal growth in the business?

Matthew M. Bilunas - *Best Buy Co., Inc. - CFO*

Sure. The Q4 SG&A, essentially, we have to first start with the idea. Our business is very different than it has been over the last few years. Over 2 years ago, the way customers were shopping, the channel they were shopping is very different. And there's just a lot more volume coming through generally compared to a couple of years ago. So as you look at a year-over-year difference, we're still seeing continued investments in technology and health being a driver of that SG&A increase.

Our advertising is also an area where it's up year-over-year. And that is included and that is the Totaltech launch that we've talked about. We're actually also increasing our store and call center labor to better support the customer experience. Last year, in Q4, it was probably -- we would say

probably running to the light from where we wanted to be. So we've made the decision to invest a little bit more from a customer experience standpoint.

And while incentive compensation was flat on a year-over-year basis in the back half of this year, it's going to be flat. The pressure in Q4 is actually a pressure in Q4 versus slight of a good eye in Q3. So those are what's driving the SG&A on a year-over-year basis. And a lot of we're doing is really focused on investing as we've talked about to make sure our customer experience is in the right spot and we're actually positioning ourselves well for the future.

Gregory Scott Melich - *Evercore ISI Institutional Equities, Research Division - Senior MD*

And maybe to flip it around a little bit, inventory up, I guess, 15% year-on-year and still 13% versus 2019. How should we think about that growth in inventory versus a comp that looks like it will be flattish in the fourth quarter, at least in your plan?

Matthew M. Bilunas - *Best Buy Co., Inc. - CFO*

Yes. I mean when you look at it versus a 2-year sales volume increase, I mean, the inventory is much more in line. We actually, when we look at our inventory, look at how many days of supply we have outstanding and we're in that very normal range of days of supply at this point. Now there's still pockets of constraint in areas like gaming consoles and things like that, but we feel really good about it on a 2-year basis. It's in line for us as we look forward to the sales.

Corie Sue Barry - *Best Buy Co., Inc. - CEO & Director*

And Greg, I would just underscore something Matt said in his prepared remarks, we were unduly light last year in inventory. And that's why we're going back to the 2-year stacked growth of right in that 13% range and then inventory 2 year in that same range. So I just think last year is not a great indicator because I think everyone was looking -- we certainly were looking for more last year.

Gregory Scott Melich - *Evercore ISI Institutional Equities, Research Division - Senior MD*

Got it. And I guess, if I could cheat with one more. Has the seasonality of the operating margin sort of fundamentally changed now with the growth of services, Totaltech? Or is that still an anomaly, you think? Or (inaudible) margins that look like the rest of the year?

Matthew M. Bilunas - *Best Buy Co., Inc. - CFO*

Yes, I think what you've seen from us this year, last year was a little unique each quarter. But this year, what you've seen is actually improved operating margin rates in each of the first 3 quarters more than what we've seen. If you look at a 2-year stack, it's much different in the first 3 quarters. I think just generally, technology is important for all our lives regardless of the seasons, and seasons that are starting to spread out across the year.

So the operating margins have on a relative 2-year basis been improving in the first 3 quarters. And quite honestly, the volumes in Q4, it's very important for us to make sure we have the right expense profile to support the customers.

Corie Sue Barry - *Best Buy Co., Inc. - CEO & Director*

Just one more little bit of color, and again, Matt said it in his remarks, but this will be the first full quarter of Totaltech too. And so you'll start to see that go through into next year as you get into those other quarters. So that makes it a little different this year comparing Q4 to the rest of the quarters. But everything Matt said in the rest of it, I mean, our goal would actually be a little bit more even business throughout the year, ultimately.

Gregory Scott Melich - *Evercore ISI Institutional Equities, Research Division - Senior MD*

Makes sense. Congrats. Have a great holiday.

Operator

Our next question comes from Kate McShane with Goldman Sachs.

Katharine Amanda McShane - *Goldman Sachs Group, Inc., Research Division - Equity Analyst*

I just had 2 questions on all the pilots that you mentioned in the prepared comments. First, with the virtual store, how are you thinking about this longer term? Do you think it will be a concept where you just need one? Or is it something that rolls out and will always be integrated into a DC? And then the flexible labor model, I know it's early and also in a pilot stage, but has this helped you at all in finding workers in this tight labor market? And how do you think about potential savings from this initiative?

Corie Sue Barry - *Best Buy Co., Inc. - CEO & Director*

So I'll start with virtual store. Obviously, really early into this. We're really just getting our legs under it. So it's hard for me to say whether or not there's more than one. The nice part is, you should be able to get very good scale from one location in a model like this, right? Because you can flexibly queue people and you can move them through at your own speed, and you could do this across all the departments in this kind of fake store that's virtual. So I don't think this is going to be about a ton of virtual stores throughout the network. I think it's going to be about scale with few locations that can provide some interesting use cases.

Because truthfully, it's not just about the customer use cases, where they might find the virtual store where they're doing digital shopping. It also could be about employee use cases, where I might be in the car installation area and may not have the expertise, but I could zoom right into one of our installation, our Autotech experts, who could help you in the moment even as an employee. It gives you a lot of confidence there, too.

So I think what we want to find out right now is what are the use cases? How often is it being used? And then ultimately, what does that customer experience look like? But like we said in the prepared remarks, we'd like what we're seeing early. And we'll see just how far you can stretch this kind of one asset that we have right now.

In terms of flexible labor, absolutely, it is helpful for us in this environment, and it's helpful on a couple of levels. One, the customer shopping behaviors have changed and they continue to change and they can change week-to-week depending on how important something like speed is, as an example. Like the week before Christmas, in-store pickup, curbside will become very important assets. And with a more flexible model, I can move employees and employees can opt into being moved to different areas in the store. That means they can pick up more hours or potentially more flexible hours.

The other thing that hasn't been brought to light as much is there still are many people calling in sick, which we want. If they're not feeling well, we want them to stay home. A model like this allows you to much more flexibly cover for those call offs. So it's not just about hiring and retention. It's actually about how can I move the labor around the store in the most flexible way.

And then the last thing I would say is, we have more employees than ever in the history of the company that are skilled in multiple areas in the store. And that isn't just about us flexibly leveraging that labor. That is about them opting into potentially schedules and even in some cases, pay grades that meets whatever they want to try to accomplish in their lives. And that's really for the employee, the more positive side of the flexible arrangement and ultimately adding to more confidence in their capabilities and their interactions with customers. That's why we tend to see higher NPS correlate very highly with multiple skill sets.

Operator

Your next question comes from Seth Basham with Wedbush Securities.

Seth Mckain Basham - *Wedbush Securities Inc., Research Division - MD of Equity Research*

My first question is around the Totaltech offering and how we think about that into 2022? Should we be thinking about 20 to 30 basis points of gross margin pressure through at least the first half of the year? And should we think about additional sales contributions building through 2022?

Matthew M. Bilunas - *Best Buy Co., Inc. - CFO*

Yes. As you can imagine, we're not in a position to guide for next year. What we've talked about is the more benefits included in Totaltech certainly are causing a near-term pressure on the business. Some of those things will continue on. A lot of what we're still trying to do is understand the incrementality, the usage, the frequency, all of those things go into understanding what the overall increment does to the business. In addition to that, incremental sales of our products, we're still in the process of evaluating. So I would imagine it to be a continued pressure heading into next year, exactly how much, we're still trying to evaluate.

Seth Mckain Basham - *Wedbush Securities Inc., Research Division - MD of Equity Research*

Got it. And then my follow-up question is, when we think about the market's growth rate potential over the next year or so, given the fact that tech is more important than ever in consumers' lives, is this market one that's likely to continue growing in the near term? Or are there pressure points because some of the year-over-year comparisons with computing and other areas have seen such a surge in growth from the pandemic?

Matthew M. Bilunas - *Best Buy Co., Inc. - CFO*

Yes. I think, certainly, it's something we're evaluating over what the market is going to look like over the next few years. We're certainly not in a position to guide next year from a sales perspective either. You're right, comping, there's going to be some big quarters next year. We grew 27% in the first half of last year. So we very much could see some bumpiness quarter-to-quarter. But again, fundamentally, we believe that our customers' need for technology has only grown and that we have a very unique way to serve those customers, and there's still a lot of long-term opportunities.

We're excited about our Totaltech membership program. We're excited about investing more in our business around technology and our operating model changing in our store portfolio. So there's a lot of room for optimism in addition to understanding that Totaltech is just that much more important. We'll have to see where the industry goes.

Corie Sue Barry - *Best Buy Co., Inc. - CEO & Director*

Yes. And just to underscore, I think you'll continue to see product innovation at an accelerated pace. And you will see CE proliferate into other areas like you're seeing it proliferate into health care or even into outdoor spaces. And so I think that makes it even harder for us to answer the question because it's not even just about how you define the market today, it's about how the market, in essence, expands over time because it taps into new areas. And that's the part that really has us excited for the future even if, to Matt's point, there might be a bumpy quarter here or there. It's really the sustainability of CE as an ever-evolving space from here on out.

And with that, I want to thank all of you so much for joining us today, and I know it's a very busy earnings season, so we appreciate it. And happy holidays to all of you, and we look forward to seeing you in March.

Operator

Thank you, ladies and gentlemen. This concludes today's presentation. You may now disconnect.

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