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OVERVIEW:

Company Summary

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by. Welcome to the Best Buy Second Quarter Fiscal 2024 Earnings Conference Call. (Operator Instructions) As a reminder, this call is being recorded for playback and will be available by approximately 1:00 p.m. Eastern Time today. (Operator Instructions) I will now turn the conference call 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 current 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 so much for joining us. Today, we are reporting better-than-expected Q2 financial results. Our comparable sales came in at the high end of our guidance and profitability was better than expected. These results continue to demonstrate our strong operational execution as we balance our reaction to the current industry sales pressure with our ongoing strategic investments. As expected, our

year-over-year comparable sales performance improved from the 10% decline we reported last quarter. For the second quarter, comparable sales were down 6.2%.

We expanded our Q2 gross profit rate 110 basis points from last year due to better product margins and profitability improvements in our membership program. We kept our SG&A expenses flat, while absorbing higher incentive compensation expenses than we recorded last year. Our industry continues to experience lower consumer demand due to the pandemic pull forward of tech purchases and the shift back into services spend outside the home, like travel and entertainment.

In addition, of course, persistent inflation has impacted spending decisions for a substantial part of the population. I continue to be incredibly proud of the way our teams are managing the business today and preparing for our future in light of the industry pressure and ongoing uncertain macro conditions. We strategically managed our promotional plan and we're price competitive in an environment where consumers are very deal-focused, and the level of industry promotions and discounts were above last year and often and above pre-pandemic fiscal '20.

In the first half of the year, our purchasing customer behavior has remained relatively consistent in terms of demographics, and the percent of purchases categorized as premium. Our inventory at the end of the quarter was down compared to last year, in line with our sales decline as the team continues to manage inventory strategically targeting approximately 60 days of forward supply. Our customer satisfaction with product availability has been improving over the past few years and is now the highest it has been since the start of the pandemic. I would note that while we were not at perfect inventory levels last year, we were more rightsized than many and are not lapping the kind of clearance pressure that other retailers experienced.

We continue to make it easy and enjoyable for consumers to get the best tech and premier expert service when they want it through our online store and in-home experiences. Almost 1/3 of our domestic revenue came from our digital assets, including our mobile app. We have made considerable improvements to our app customer experience, and the percent of our online sales coming through the app has doubled in just the last 3 years to more than 20% of our online revenue. We are pleased to see higher app usage overall as our app customers engage 3x more often than customers engaging with us on other digital platforms.

Our buy online, pickup in store percent of online sales continues to be just over 40%. Considering the speed of our delivery, with almost 60% of packages delivered within 2 days, we believe the consistency of our high rate of in-store pickup by our customers truly underscores the importance of the combination of our digital and physical locations. In addition, our focus on providing customers with expertise and support continues to be highlighted by material improvements in satisfaction scores for our in-store and in-home tech services as well as our home delivery experience.

In fact, our remote support services, where we have the ability to remotely access and fix your computer while you're at home, has the highest NPS of all our experiences and continues to increase. These are all services we can provide at scale that no one else can. Our tech services play a material role in our unique membership program that is driving increased customer engagement and increased share of wallet. As we would expect, paid members also report much higher customer satisfaction than non-member customers. During the quarter, we successfully launched significant changes to our program designed to give customers more freedom to choose a membership that fits their technology needs, budget and lifestyle.

In addition, we wanted to build in more flexibility and drive a lower cost to serve than our previous total tech program. We now offer 3 tiers: My Best Buy, My Best Buy Plus and My Best Buy Total. It is, of course, very early as we only launched the new programs on June 27, but we are seeing indicators that the program changes are driving many of the results we expected, including an uptick in year-over-year growth of overall paid membership sign-ups.

For example, My Best Buy Total, which is the evolution of our prior total tech offer continues to resonate more strongly in our physical store setting. As a reminder, this tier is \$179.99 per year and includes Geek Squad 24/7 tech support via in-store, remote, phone or chat on all your electronics no matter where you purchase them. It also includes 2 years of product protection, including AppleCare Plus on most new Best Buy purchases.

In addition, it includes all the benefits included in My Best Buy Plus. And as a reminder, My Best Buy Plus, is a new membership tier built for customers, who want value and access. For \$49.99 per year, customers get exclusive prices and access to highly anticipated product releases. They also get free 2-day shipping and an extended 60-day return in exchange window on most products. In the first several weeks since launch, this plan is

resonating more with digital customers, and appeals to a broader set of customer segments across more product categories than My Best Buy Total and its predecessor, Total Tech. We are still very early in the process and are testing different promotional offers to determine what resonates most with consumers and continuously improving the digital experience to make it even easier to find deals and benefits.

Lastly, our My Best Buy Tier remains our free plan built for customers, who want convenience. It includes free shipping with no minimum purchase and other benefits associated with a member account like online access to purchase history, order tracking and fast checkout. At the beginning of the year, we added the free shipping benefit and phased out the points-based rewards benefit for non-credit card holders.

As a reminder, our credit card holders still have the option to earn 5% back in rewards or those chose 12 months, 18 months or even 24 months of 0% interest rate financing depending on the product category. The customer metrics continue to validate our decisions to change our free tier and our customer enrollments have remained steady. In addition, the financial impact has been better than we originally modeled.

For fiscal '24, we now expect our 3-tiered membership program to contribute at least 25 basis points of enterprise year-over-year operating income rate expansion, which is consistent with what we have seen in the first half of the year. During the quarter, we continued to make progress on our journey to evolve our omnichannel capability. We want to ensure we maintain a leading position in an increasingly digital age and evolving retail landscape. This means our portfolio of stores needs to provide customers with differentiated experiences and multichannel fulfillment. At the same time, we need them to be more cost and capital efficient to operate, while remaining a great place to work.

We are on track to deliver the fiscal '24 physical store plans we announced at the beginning of the year. These include closing 20 to 30 stores, implementing 8 large format 35,000 square foot experience store remodels and expanding our outlet stores from 19 to around 25. In addition, of course, we are continuing to refresh our stores. For fiscal '24, we are particularly focused on improving the merchandising presentation given the shift to digital shopping and corresponding lower need to hold as much inventory on the shopping floor.

For example, in all our stores, we are installing new premium end caps in partnership with key vendors, that will improve the merchandising in the center of the store. These new end caps have that product and vendor story on the front with the inventory tucked in on the side. Importantly, it allows us to have a great demo or presentation even if we are displaying potentially less in-store inventory than we historically have. This also allows for a much better merchandising experience for products that we have deemed more at risk for shrink and have decided to hold inventory in a more secure location off the sales floor.

We invested in digital tools that allow the customer to quickly scan and pick up this inventory in a matter of minutes through our prioritized pick process. This minimizes shrink, prioritizes the customer experience and drives a much more efficient employee process.

In addition, in about half our stores, we are rightsizing our traditional gaming and digital imaging spaces to allow for expansion of growing categories like PC gaming, and newer offerings such as GreenWorks cordless power tools, wellness products like the Ouraring, Epson, short-throw projectors, e-bikes and scooters and Lovesac home furnishing products. While small, we are seeing promising results in some of these new categories with meaningful market share growth.

As it relates to the operating model in our stores, we are continuing to drive our evolution based on 2 overarching goals. First, we needed to more efficiently allocate our labor cost, considering the higher online sales have resulted in a decline in physical store traffic and sales. Our customers and their expectations and behaviors have changed dramatically and incredibly quickly. We have been working hard to balance the amount of labor hours necessary to deliver the best experience possible for our customers and employees.

Not all roles and the associated hourly pay are the same. And we have had to make some difficult, but strategic decisions to give us the ability to flex our labor spend appropriately. As we mentioned last quarter, with our most recent changes, we were able to add approximately 2 million additional hours for customer-facing sales associates into our staffing plan for the year. And we saw improvement in our associate availability NPS metric in the second quarter as a result. Because of these structural changes, we have driven more than 100 basis points of rate improvement in domestic store labor expense as a percent of revenue compared to fiscal '20. Additionally, we've been successful in keeping our labor rates steady as a percent of revenue, even as our sales have declined over the past several quarters.

Second, we need to provide our employees flexibility, predictability and opportunities to gain more skills. We have been investing in tools and employee development programs that increase their flexibility within and across stores. As you would expect, we are also focused on leveraging existing and emerging technology to drive better customer and employee experiences across channels. We are gratified that our employee retention rates continue to outperform the retail industry, particularly in key leadership role, the vast majority of which we hire internally.

Our retail workforce has led through significant change over the past 4 years. I could not be more proud of how our teams have adapted to the changing environment. But all that change, while necessary, and be hard and disruptive for any team. We are pleased to be headed into a period of stability from an operating model perspective, and we are now laser-focused on ensuring foundational retail excellence. As such, during Q2, we led thousands of employees, including more than 80% of our sales associates through a certification process focused on our baseline expectations for interacting with customers, our selling model and product category proficiency.

This is just Phase 1, and we will continue to invest in training hours for subsequent phases of the program to make sure we are driving the interactions and outcomes we believe are the best for our customers and our business. As I mentioned earlier, we are working hard to balance our response to current industry conditions with our need to invest in our future. It has long been part of our cultural DNA to drive cost efficiencies and expense reductions in order to offset pressures and fund investments, and this year is no different.

In fiscal '24, we are driving benefits from optimization efforts across multiple areas, including reverse supply chain, large product fulfillment and our omnichannel operations. This includes leveraging technology and rapidly evolving AI. For example, in customer care, our virtual agents are now answering 40% of customer questions via chat without a human agent and with high satisfaction level. We are continuing to add capabilities and are creating additional employee and customer-facing virtual agents that will simplify our most complex interactions like technology support services, while also delivering key insights from our customer care centers back into the enterprise.

We are also testing new state-of-the-art routing capabilities to optimize our in-home operations, reducing cost of service and improving the availability and wait time of delivery and installation appointments for our customers. As we think about our growth strategies, we believe we can leverage our scale and capabilities to drive incremental profitable revenue streams. In this vein, we are exploring Geek Squad as a service opportunities with several large companies, including Accenture, KingEL and Lenovo, as we have created differentiated B2C and B2B services capability.

Device life cycle management is a specific example of the service we can provide others, a necessity for all companies, device life cycle management refers to the process of providing tech devices like phones and laptops to employees. This is not a core competency for most companies and the recent hybridization of work has made it even more complicated. We are already supporting a number of firms as their sole device life cycle management partner, providing end-to-end support of these company-provided devices, including procurement, provisioning, deployment, repair and end of life.

This is just one example of our ability to leverage our data and assets and adds to the growth we are already seeing in areas like Best Buy Ads and Partner Plus. Before my closing remarks, I also want to take a moment to recognize our Geek Squad teams for their work with our communities. For more than 15 years, they have been sharing and teaching their tech expertise and skills to prepare the next generation for the future workforce.

This summer, we welcomed more than 2,000 kids and teens at nearly 40 Geek Squad Academy camps across the country. These camps give participants the opportunity to learn skills on everything from coding, game design, digital music and more. More importantly, they help young people build self-confidence, spark creativity and discover how technology can benefit them in their educational pursuits and future careers. I'm incredibly proud of all our Geek Squad agents and volunteers for their work this summer, inspiring thousands of young minds through tech.

As we enter the second half of the year and look forward to the holiday season, we are both pragmatic and optimistic. Of course, the macro environment remains uncertain with a number of tailwinds and headwinds, soon including the October resumption of student loan payment, all of which results in uneven impacts on consumers. Overarchingly, we believe that the consumer is in a good place. But as we have said, they are making careful choices and trade-offs right for their households.

During last quarter's conference call, we noted that we were preparing for a number of scenarios within our annual guidance range, and we believed our sales were aligning closer to the midpoint of the annual comparable sales guidance. We knew it would be a challenging year for the industry,

and we are halfway through the year and narrowing our outlook largely as expected. As Matt will discuss in more detail, we are updating our comparable sales guidance accordingly.

We now expect comparable sales to decline in the range of 4.5% to 6%. This compares to our previous range of down 3% to down 6%. At the same time, we are narrowing our profitability ranges effectively raising the midpoint of our previous annual guidance for non-GAAP operating income rate and earnings per share. We continue to expect that this year will be the low point in tech demand after 2 years of sales declined. Tech is a bigger part of all our lives, both in our homes and in our businesses than ever.

And we believe next year, the consumer electronics industry should see stabilization and possibly growth driven by the natural upgrade and replacement cycles for the tech brought early in the pandemic and the normalization of tech innovation. Let me say a few words about the fourth quarter specifically. For context, we reported a comparable sales decline of 10% for fiscal '23 and roughly 8% for the first half of this year. We are guiding a Q3 year-over-year comparable sales decline that is similar to or a little better than the 6.2% decline we just reported for Q2.

Our full year guidance implies a wide range for Q4 comparable sales of down 3% to slightly positive. There are a number of factors supporting our belief that our Q4 year-over-year comparable sales will improve and could potentially turn positive. We expect growth in home theater as we expect to be better positioned with inventory across all price points and budget spend last year.

We are starting to see signs of stabilization in our home theater business. For example, TV sales trends improved in Q2 and units returned to growth. We expect performance in our computing category to improve as we build on our position of strength in the premium assortment. While not exactly linear, we are also starting to see signs of stabilization in this category as Q2 laptop sales trends improved materially and units were flat to last year. We expect to see continued growth in the gaming category as inventory is more readily available and there is a promising slate of new software titles expected to be released in the back half of the year.

We are planning for potential growth in the mobile phone category as we expect inventory to be less constrained than last year and expect to drive growth in our unlocked phones business. Our hypothesis regarding the holiday season is that the consumer largely returns to pre-pandemic behavior. By this, we mean that they will be looking for great deals and convenience and traffic will be weighted toward promotional events. We have an excellent team and strong omnichannel assets that thrive in such an environment.

In summary, while the macro and industry backdrop continue to drive volatility as we move through the year, we have a proven track record of navigating well through dynamic and challenging environments, and we will continue to adjust as the macro conditions evolve. And we remain incredibly excited about our future opportunities.

While our existing product categories have slightly different timing nuances, in general, we believe they are poised for growth in the coming years. In addition, we continue to see several macro trends that should drive opportunities in our business over time, including cloud, augmented reality, expansion of broadband access and of course, generative AI, where we know our vendor partners are working behind the scenes to create consumer products that optimize this material technology advancement.

As the largest CE specialty retailer with 1/3 of the U.S. computing and television market share, we can commercialize new technology for customers like no one else can. And with that, I would like to turn the call over to Matt for some more details on our second quarter results and our fiscal '24 outlook.

Matthew M. Bilunas - *Best Buy Co., Inc. - Senior Executive VP & Enterprise Strategy & CFO*

Good morning, everyone. Let me start by sharing details on our second quarter results. Enterprise revenue of \$9.6 billion declined 6.2% on a comparable basis. Our non-GAAP operating income rate of 3.8% declined 30 basis points compared to last year. Non-GAAP SG&A dollars were essentially flat to last year and increased approximately 140 basis points as a percentage of revenue. Partially offsetting the higher SG&A rate was a 110 basis point improvement in our gross profit rate. Compared to last year, our non-GAAP diluted earnings per share of \$1.22 decreased \$0.32 or 21%, with approximately half of the decrease due to a higher effective tax rate.

When viewing our performance versus our expectations entering the quarter, our revenue was at the high end of the range we provided. Our non-GAAP operating income exceeded our expectations due to a higher gross profit rate driven by a number of areas, including lower cost to serve for our membership offerings, higher profit sharing revenue from our private label credit card arrangement and lower supply chain costs.

Next, I will walk through the details on our second quarter results compared to last year. From an enterprise comparable sales phasing perspective, June's decline of approximately 5% was our best performing month on a year-over-year basis, with May and July, both down approximately 7%. As we have started Q3, our estimated comparable sales decline in the first 4 weeks of August was approximately 6%. In our Domestic segment, revenue decreased 7.1% to \$8.9 billion, driven by a comparable sales decline of 6.3%. From a category standpoint, the largest contributors to the comparable sales decline in the quarter were appliances, home theater, computing and mobile phones, which were partially offset by growth in gaming.

From an organic perspective, consistent with the past several quarters, our overall blended average selling price declined in the low single digits as a percentage versus last year. In our International segment, revenue decreased 8.8% to \$693 million. This decrease was driven by a comparable sales decline of 5.4% and a negative impact of foreign exchange rates.

Our Domestic gross profit rate increased 110 basis points to 23.1%. A higher gross profit rate was driven by the following: first, our product margin rates improved versus last year. The better product margin rates included a higher level of vendor-supported promotions and the benefits from optimization efforts across multiple areas. Second, improvement from our membership offerings, which included a higher gross profit rate in our services category. And third, an improved gross profit rate from our health initiatives.

Domestic non-GAAP SG&A dollars were flat to last year as higher incentive compensation was largely offset by reduced store payroll costs. Moving next to capital expenditures, where we still expect to spend approximately \$850 million this year. This reflects a reduction of \$80 million compared to the last year, with lower store-related investments being the primary driver of the reduced spend. Year-to-date, we have returned a total of \$560 million to shareholders through dividends of \$402 million and share repurchases of \$158 million. We expect to continue share repurchases throughout fiscal '24 with the level of share repurchases being slightly higher in the second half of the year compared to the first half.

As I referenced earlier, our non-GAAP effective tax rate of 26.6% was higher than a 16.7% rate last year. The lower effective tax rate last year was primarily due to the resolution of certain discrete tax matters.

Now I would like to discuss our fiscal '24 outlook. As Corie mentioned, we are lowering the high end of our full year revenue outlook to our previous midpoint while keeping the low end of our revenue guidance unchanged. At the same time, we are narrowing our non-GAAP OI rate and EPS ranges in a way that raises the midpoint of our previous annual guidance for those items.

Let me provide more details on our guidance and working assumptions, starting with the revenue. We expect enterprise revenue in the range of \$43.8 billion to \$44.5 billion. The Enterprise comparable sales decline of 4.5% to 6%. Moving on to our full year profitability guidance, which is Enterprise non-GAAP operating income rate in the range of 3.9% to 4.1%, and non-GAAP diluted earnings per share of \$6.40.

Our outlook remains unchanged for a non-GAAP effective income tax of approximately 24.5% and for interest and income to exceed interest expense this year. As a reminder, the fourth quarter of fiscal '24 contains an extra week. We expect this extra week to add approximately \$700 million of revenue, which is excluded from our comparable sales and a \$100 million of SG&A. We still expect it to benefit our full year non-GAAP operating income rate by approximately 10 basis points.

Next, I will review our full year gross profit and SG&A working assumptions. We now expect our full year gross profit rate to improve by approximately 60 basis points compared to fiscal '23, which compares to our prior outlook of 40 to 70 basis points of expansion.

The primary drivers of the rate expansion include the following: first, improvement from our membership offerings, which includes a higher gross profit rate in our services category, our membership offerings are now expected to provide at least 25 basis points of improvement; second, higher product margin rates, which includes the benefits from our optimization efforts across multiple areas, and a higher level of vendor-supported promotions; and third, our health initiatives is also expected to improve our gross profit rate. Lastly, we expect the profit sharing from our private

label credit card to have a relatively neutral impact to our annual gross profit rate comparing to last year. The profit sharing has provided a slight benefit to our gross profit rate in the first half of the year, which is expected to turn to a slight pressure in the second half of the year.

Now moving to our SG&A expectations. At the midpoint of our guidance, we expect SG&A as a percentage of sales to increase approximately 100 basis points comparing to last year. We expect higher incentive compensation as we lap the very low levels last year. The high end of our guidance now assumes incentive compensation increases by approximately \$185 million comparing to fiscal '23. We continue to expect store payroll and advertising expenses to be approximately flat to fiscal '23 as a percentage of sales. As it relates specifically to the third quarter, we expect our comparable sales to be slightly better than the negative 6.2% we reported for the second quarter.

On the profitability side, we expect our non-GAAP operating income rate to be approximately 3.4%. This would represent a decline of approximately 50 basis points versus last year, with the contributions from SG&A and gross profit pretty similar to what we saw in the second quarter.

Lastly, I will share some color on what our guidance implies for the fourth quarter. As Corie discussed, we are planning for multiple revenue scenarios that range from a comparable sales decline of approximately 3% to slightly positive. Our Q4 gross profit rate is expected to improve versus last year, but not at the same level as we are expecting for the full year. SG&A as a percentage of sales is expected to be more favorable than our full year outlook, which is primarily due to the extra week and the more favorable revenue outlook.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And your first question comes from the line of Scot Ciccarelli from Truist.

Scot Ciccarelli - Truist Securities, Inc., Research Division - MD

Corie, you mentioned some of the newer technology kind of waiting in the wings with AI and stuff. Can you give the group any kind of flavor for some of the technologies, like generically that you guys are thinking about that could potentially drive improvement in sales trends?

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

Yes. Maybe in this, we were talking about computing specifically, and maybe I'll give just a little bit more color there. I mean, I think what we're seeing broadly is that computing innovations and the refresh cycles are getting shorter and they're accelerating. And we continue to see people using all of their devices more often and far more like computing processing intensive. And these are really specific activities. And you can see it both whether you're using it at home and you're seeing a lot more streaming or whether using it at work and you're starting to want to leverage some of these more advanced technologies.

Obviously, like for an example, Microsoft pre-pandemic focused on dual screen, and that was kind of something we had talked about for a while, but they quickly pivoted some of their developments within their Windows OS to address consumer productivity. As all of us were kind of struggling to make sure we are as productive as possible on multiple devices, a lot of that enhancement went into productivity. And I think the emergence of AI is at the heart of many of these innovations. I think in this case, in this example, it centers around the Windows Copilot on Windows 11, which brings ChatGPT and AI innovations into cloud applications within that Windows Office suite within PowerPoint, Outlook, Excel.

And I think what we're expecting will happen, and I alluded to it on the call is, obviously, we're going to have a likely at some point here, different generation of technology that's going to more intensively leverage the capabilities that are necessary to run these AI models. So that's 1 example.

We talk about this often, Scot. It's hard for us always to know exactly what that new horizon of technology is going to be. But this is one that probably has some of the broadest implications for all of our collective productivity.

Scot Ciccarelli - *Truist Securities, Inc., Research Division - MD*

Yes, understood. And then the second question is the expectation for slight improvement in comp despite a little bit more difficult comparison. Is that really driven by you have more events in the third quarter than the second quarter as we revert to pre-pandemic behavior?

Matthew M. Bilunas - *Best Buy Co., Inc. - Senior Executive VP & Enterprise Strategy & CFO*

No. I think for Q4 specifically, I think as we think about improvement of trends for Q3 and then in Q4, I think we are obviously encouraged by -- a little bit by back-to-school. Back-to-school has been slightly better than we expected as we get into Q3. When you think about Q3 compared to FY '20, it actually is slightly higher growth than what we saw in -- expecting slightly higher growth in Q3 compared to Q2.

Q3 compared to '20 has a little bit more holiday sales pulled in. So we are expecting that to continue compared to where pre-pandemic was, but maybe not to the same extent of pull forward that we've seen in the last few years. So I think we're encouraged by the trends as we leave Q2. If you think about what happened in Q2, we actually saw some stabilization in our business. We saw actually laptop units turned to flat in Q2 in terms of that business in TV units were flat. And so I think there's optimism around how -- what we might expect for the back half, more specifically Q4. But Q3 we're likely still seeing similar levels to what we saw in Q2.

Operator

Your next question comes from the line of Greg Melich from Evercore ISI.

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

I wanted to start on the top line that's sort of improvement in trend and love an update on what credit is it a penetration. And also, you mentioned that, that was a tailwind becoming a headwind. Could you frame that a little bit more as to what percentage of gross profit it is or something like that?

Matthew M. Bilunas - *Best Buy Co., Inc. - Senior Executive VP & Enterprise Strategy & CFO*

Yes. I think for the -- on the credit side, specifically first, we've talked about the credit card portfolio is 1.4% of our domestic sales, 1.4%. So it's pretty similar to what we had said last time. I think overall, what we've been seeing for the last number of years is a tailwind for the credit card portfolio, a profit share. It certainly -- it came in a little better than we expected in Q2. We are seeing net credit losses normalize to where they were pre-pandemic. I think the thing we're watching for which is based on the state of the consumer, do those net credit losses actually turned to higher than they used to be, which would create pressure on the profit share.

And in the back half of this year, we are expecting it to be a slight pressure compared to the first part of the year being a benefit for us, but neutral for the year. So it's really that net credit loss. This is one aspect we're watching, especially as we get into next year and we think about what the state of the consumer does look like as you get into next year and increasing levels of debt. So still an amazing book and partnership for us in terms of what it does for our consumers and offering a great way to pay for product. It actually also is a very loyal consumer. So we're really happy with the -- probably just a reality of what we've been trying to normalize a bit, if you will, from the last few years.

I think to the improving trends, I think Q3, we're expecting to be a pretty similar, maybe slightly better comp than we saw in Q2. Like I said earlier, back-to-school is that little better than we expected, but it's running a little longer, and little later into the season. And then if you look to Q4, while we are expecting the year-over-year comps to improve to at the bottom of the range, minus 3 or the top slightly positive, and it still does represent

the fact that against FY '20, you're anywhere from down 7% to down 3% on the high end. So yes, we believe the year-over-year trend should improve based on a number of the things that Corie mentioned. It still does represent a more stabilization of our consumers as you look into the back half of the year, when you think about a more normalized volume that we had pre-pandemic.

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

Got it. And then a follow-up is on SG&A specifically. I know you expect it to delever for the year. You mentioned the incentive comp up \$185 million. Was that for the full year or in the back half? That would be for the full year?

Matthew M. Bilunas - *Best Buy Co., Inc. - Senior Executive VP & Enterprise Strategy & CFO*

Yes, that's for the full year.

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

And is that -- that's more back-half weighted presumably?

Matthew M. Bilunas - *Best Buy Co., Inc. - Senior Executive VP & Enterprise Strategy & CFO*

It's pretty even throughout the year.

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

Okay. And then the -- in terms of leveraging payroll, that 100 bps was in the second quarter. Was there something about the second quarter that gave you an unusual amounts of hourly payroll leverage? Or should we expect that going forward?

Matthew M. Bilunas - *Best Buy Co., Inc. - Senior Executive VP & Enterprise Strategy & CFO*

No. I think for the year, we expect store payroll to be relatively flat on a percentage of sales basis for the whole year. It's been pretty consistent across the -- has been pretty consistent across the quarters, and we would expect it to be pretty consistent in the back half of the year as well.

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

And Greg, just to make sure we're clear that 100 basis points is versus FY '20. So that's more the like structural change that we've seen over the last 4-ish years.

Operator

Your next question comes from the line of Seth Sigman from Barclays.

Seth Ian Sigman - *Barclays Bank PLC, Research Division - Research Analyst*

I just wanted to follow-up on that credit point. So neutral for the year, negative in the second half of the year slightly. Can you just size up for us what normal means if that continues into next year? I think your disclosure is that it's up 50 basis points or so since fiscal 2020. So does normal mean that fully reverses? How do we think about that?

Matthew M. Bilunas - *Best Buy Co., Inc. - Senior Executive VP & Enterprise Strategy & CFO*

Yes. I think my reference to normal, thanks for the question, is more related to net credit losses as a percentage to the book. So we haven't given that number, and I won't give it today, but what we're seeing now is a more normal rate compared to FY '20. What we're watching for is does that rate increase compared to where it used to be. And certainly, it's already higher than it has been the last few years, when the net credit losses were very low rate.

And that is just more to do with just the state of the consumer. So right now, we still see a relatively good consumer to the extent that they're still continuing to make trade-off decision weighing a little bit more pressure on their personal finances. That net loss could go up into next year. That's the consideration we watch. Certainly, as we think about next year, we're not guiding next year, but as you think about next year, that could be one of the pressures we face as we think about ROI rate just in terms of where does the net credit losses go.

Seth Ian Sigman - *Barclays Bank PLC, Research Division - Research Analyst*

Okay. Just any other perspective on credit availability today, if that's impacting demand in any way? And maybe just put that in context of some of the trends that you may be seeing across consumer cohorts or markets. Obviously, you talked about some of the bright spots you've seen in recent months here and what you're expecting for the rest of the year. I'm just trying to think about some of the incremental consumer headwinds ahead, whether that's student loans or credit availability. Just any other context around some of the consumer behavior you may be seeing where that's coming from?

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

Right now, as it relates specifically to the card, we aren't seeing massive change in credit availability. We're continuing to see -- and we've said before, about 25% of our business is done on the card. We're continuing to see those trends. And one of the nice things about our card is, and I mentioned it in the prepared remarks, but I want to emphasize it, you can either choose points or you can choose 0% financing.

And so it's actually -- it's an offering that is widely accepted and appreciated, especially against the backdrop, so the consumer can decide what's more relevant for them. So like Matt said, we're seeing more of a normalization in some of those key metrics. But in general, it remains an incredibly efficient asset for us in partnership, obviously, in the profit share structure that we have.

Operator

Your next question comes from the line of Liz Suzuki from Bank of America.

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

So just a question on appliances, which looks like they were particularly weak this quarter. And some other big box retailers that sell appliances have talked about an increase in vendor-funded incentives and promotions. Have you seen the same behavior from your vendor partners as they try to respond the slower demand? And did vendor funding -- funded promotions have an impact on margins this quarter?

Matthew M. Bilunas - *Best Buy Co., Inc. - Senior Executive VP & Enterprise Strategy & CFO*

Yes. Broadly speaking, we are seeing an increase in vendor-funded promotions across all of our categories, and I think appliances would be part of that. I think as you -- as we've noted in our gross profit rate improvement in Q2, a lot of that was coming from our product margin rates being better year-over-year. Part of that is we're seeing an uptick in the vendor-supported promotions that we are running. So yes, it is a more promotional

environment year-over-year and in some cases, it's certainly more than it was in FY '20, but it hasn't manifested in lower product margins for us because we are seeing both -- not just us, our vendors wanting to engage in promotional activity to drive and stimulate demand.

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

Great. And just on the flip side of some of the categories that were particularly strong. Can you just go into a little more detail on what was successful in like the entertainment and services categories? And where you see that going in the next couple of quarters?

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

Well, on the entertainment side of things, that really is reflective of gaming, and particularly gaming hardware, which had a much more stable supply this year than what we saw last year. So we feel like that's a nice indicator as we're heading into the back half of the year. We mentioned that. And on the services side, that really is made reflective of our membership offering and now starting to kind of annualize this higher larger cohorts of members.

Operator

Your next question comes from the line of Michael Lasser from UBS.

Michael Lasser - *UBS Investment Bank, Research Division - MD and Equity Research Analyst of Consumer Hardlines*

Matt, you alluded to operating margin pressure in the next fiscal year. So on a similar level of revenue for Best Buy, call it 2024 versus where it was in 2019, what would be the company's operating margin rate in light of the pressure that it's experienced from investments in health care and some of the impact of the rise in e-commerce penetration for the business and all the actions that the company has taken to try and preserve the profitability in light of those pressures? And what levers can be pulled from here in order to improve the operating margin rate over time, especially as things like credit income continue to decline.

Matthew M. Bilunas - *Best Buy Co., Inc. - Senior Executive VP & Enterprise Strategy & CFO*

Thanks for the question, Michael. What I just to clarify what I was referring to specifically was potential pressure on the credit card profit share as we look into next year. What I was trying to characterize was like overall OI pressure for next year. But to get to your broad question there, I think as you can appreciate, we're not going to guide next year. But that being said, if, for example, our sales were flat next year as some of the indicators would suggest, it would be our expectation or goal to at least hold OI rate flat, if not drive a little bit of expansion.

Like I said, there are a few factors here. The first being that credit card, it's been a tailwind for us. And like I said, it could turn to some pressure. The second more tactical one is, as we enter into next year, we always reset incentive compensation this year. We have a certain amount to spent next year. But we reset the one that does sometimes create a little bit of rate pressure. But broadly speaking, if you think about next year and the years outward, a lot of the other drivers are going to be -- the things like, the level of industry growth to the extent that the industry can grow and does grow, we expect to grow with it. And that does create SG&A leverage as our cost structure today is probably more indicative of a sales number that's higher than where we sit.

We've talked about this year being a benefit for us, both the membership and the health initiatives the rate has been improving. So similar to our Investor Day a while back, we would expect those initiatives to continue to improve in terms of rates as we look forward from here on out, so into next year and in the years after both membership and health would continue to help drive a year-over-year improvement. We also obviously always trying to have cost takeout initiatives to help mitigate pressures that we face, and just help us invest in the right places.

But again, like I said, the profit share could become a pressure from NCL. The other thing to note in terms of the profit share is there's potential regulatory changes around late fees now. It's too early to know whether those do or don't come, but that's another item to note. And lastly, I think, I'd mention is just we're still in a consumer environment, where it's a little uneven, unsteady. And so I think as we think about going forward, a lot of it will depend -- the industry growth will depend upon that consumer and where they choose to spend their money. But I think, like I said, our goal would be to at least maintain a flat rate, if not grow a little bit if we have flat sales, for example.

Michael Lasser - *UBS Investment Bank, Research Division - MD and Equity Research Analyst of Consumer Hardlines*

My follow-up question is there's an interesting dynamic that you're referring to on your call, which is the promotional environment, in some cases, it's higher or more intense than it was in 2019, but you're getting more vendor funding than you were getting at least relative to last year. So, a, how much is your vendor funding up or down relative to 2019? And b, what is this overall promotional environment suggests about the profit pool for selling consumer electronics in the United States invest by share of that overall profit pool.

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

So question one, overall vendor funding upgrade. We're not going to say total amounts of vendor funding. But you can imagine, at any given point in time, our vendors like us are trying to think in a very omni-channel way how best can we both stimulate demand and complete excellent customer experiences. When we kind of like look all in at everything our vendors do with us, we feel confident that we have at least as much, if not more, like total funding in partnership with our vendors.

But of course, they're going to use different pockets depending on the environment that we sit in. I think on your profit pool question, Michael, what's interesting is our vendors -- and we've said this for a long time. Our vendors are as interested as we are in stimulating consumer demand. Sometimes, that means they lean highly into innovation and trying to drive replacement cycles and trying to drive that incremental demand through innovation. Sometimes, that means we partner closely together in how we show up in stores, whether that's physically or in labor. And then sometimes that means we will partner together in highly promotional or value-oriented periods to make sure collectively, we are putting our best foot forward.

And it goes back to some of what I ended my comments with, there is a larger installed base of consumer electronics out there. And this is not static equipment we all have. This is equipment that whether or not you want to upgrade it, sometimes just wears out and breaks. And this is our unique place in this consumer electronics industry in partnership with our vendors, we are arguably the best at commercializing that new technology or bringing kind of this total story agnostic, just caring about the customer to life. And I think what you're seeing is -- this in this period right now, our ability to help drive value in partnership with our customers is really highlighted.

Operator

Your next question comes from the line of Kate McShane from Goldman Sachs.

Katharine Amanda McShane - *Goldman Sachs Group, Inc., Research Division - MD & Retail Analyst*

We wanted to ask a little bit more about the membership strategy, which is now in the 3 tiers. Can you talk about how the profitability differs when compared to your previous program of total tech support? And does this profitability improve as the program scales and ramps?

Matthew M. Bilunas - *Best Buy Co., Inc. - Senior Executive VP & Enterprise Strategy & CFO*

Sure. Yes. I think the changes we've made to the membership program have had a positive impact on our OI rate this year. I think we've talked about it being at least 25 basis points for the year. It's coming from a few different areas. The first area I would say is the changes we made to the

My Best Buy program, the free membership where we move points away from that program, which is solely on the credit card, that helps drive some improvement in rate.

The cumulative growth in the members is also a place, where it actually helps improve our margin rates as well. So the growth in the annual membership fees does drive some of the improvement as well. Lastly, the changes we've made to the total tech program and turned into My Best Buy Total does lower the cost to fulfill and it helps drive an improved gross margin rate as well. So those are the collection that drive the at least 25 basis points. And then Corie, can speak to any sort of strategic things around the membership team.

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

I think what's most important is that at any given point in time, what the team -- I would argue, has done a magnificent job doing is balancing acquisition, retention and engagement. And while, to Matt's point, cost to serve is part of our consideration, what we want are not just to acquire a bunch of members, but to make sure they are incredibly engaged and to make sure we retain them over time.

And so while the profitability impact is part of what we're looking at, the bigger question we are actually looking at is what is that combination of acquisition, retention and engagement that drives what we talked about, which is more sticky customers that bring a larger share of wallet and help keep Best Buy relevant over time.

Katharine Amanda McShane - *Goldman Sachs Group, Inc., Research Division - MD & Retail Analyst*

And then our follow-up question was just around market share. We wondered if you've been seeing any kind of meaningful change here, whether it would be sequentially or just in any specific categories?

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

Well the good news is, overall, we feel very strongly about our position in the industry, and we talked about it already a bit. We are confident in our relationship with our vendors and grateful for their partnership. And I think we continue to be excited to keep investing in our strategy from a position of strength. We've said before, there is not a great single source for market share, both because we have a large portfolio of services also because we are always evolving new categories.

But from what we can see in some of the more established categories, we have at least held our share in Q2, and we believe that's been through really in the first half of the year. So no major trajectory change. We feel like we're positioned well. And obviously, the team will continue to work with our vendor partners and ensure that we have that great valuable assortment for our customers.

Operator

Your next question comes from the line of Brad Thomas from KeyBanc Capital Markets.

Bradley Bingham Thomas - *KeyBanc Capital Markets Inc., Research Division - MD & Equity Research Analyst*

I was hoping we could talk a little bit more about kind of the inflation, deflation, and what you've been seeing of late and how you're thinking about that in the back half of the year, particularly given the inflationary world that we've all been living in, but this backdrop of consumer electronics that historically have been deflationary?

Matthew M. Bilunas - *Best Buy Co., Inc. - Senior Executive VP & Enterprise Strategy & CFO*

Sure. I think broadly speaking, I'll start with the categories. I think what we said from a product perspective, we've certainly seen a little bit of inflation over the years. But what we're now seeing actually is more promotionality on a year-over-year basis, in some cases, compared to FY '20. So from a category product perspective, I think we're kind of beyond past the inflation aspects that there isn't some cost of good increase. But generally speaking, the prices have gone up. So I think that hasn't changed too much outside of like the sometimes more promotionality is dropping that price on an year-over-year basis.

I think for inflation in other areas in terms of cost, there are things that historically have always had a little bit of inflation, that probably will continue to go up. Wages in an area where we always expect to have a little inflation. Marketing also is a place where you see some pretty consistent inflation over the years. Supply chain is the more notable one, but I think where we've seen a lot of inflation over the years, and now it's starting to subside a little bit. Supply chain has a number of different areas, one of them being the ocean side of supply chain. That's the smallest cost that we have. And that's an area where inflation actually has come down.

Ground transportation or the domestic transportation actually is an area where we are still seeing a higher level of inflation based on the wages that have -- the wage pressures and just that the volume that's increased. The warehousing side of supply chain is also where we've seen inflation, and we'd probably expect to continue to see some. We also have wage inflation on the warehousing side, but also just we've expanded our footprint because our large products have grown in terms of the mix of our categories that we needed to add space. So broadly speaking, there are some areas where we'll probably continue to see inflation, in some areas that will abate a little bit as you get into next year and years out.

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

Brad, explicitly, I want to highlight, we started talking about this category becoming promotional again in the fall of 2021. And so this is a category very different than some of what you're hearing, and I'll just use an example like lumber, where you're starting to see that pull back. That is not the case here. But structurally, we have seen ASPs increase. So to your point about this is generally seen as a deflationary category. We spent some time talking on the last call about the fact that actually, over time, it is not necessarily deflationary because every single new rev of product carries with it a new and different price take.

So actually, over the longer period, when we look back to FY '20, we have seen structural increases in ASP, but that is due more to our premium mix, and it's due more to having more high ASP products like appliances and home theater. And so I just want to make sure I'm explicit in saying this is a bit of a different category and the pricing side of things. Matt did an exceptional job on some of the costing side of things, but we're in a different place than many other industries and categories.

Bradley Bingham Thomas - *KeyBanc Capital Markets Inc., Research Division - MD & Equity Research Analyst*

That's really helpful. And if I could squeeze in one follow-up here around the topic of shrink. Corie, you mentioned some of the new displays you have that have been helpful. But can you just help to put into context the success that you're seeing in this tough environment, given that there are so many retailers calling out challenges on shrink right now?

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

Yes. I will start with our #1 priority is and always has been the safety of our customers and our employees. And I need to be clear that in certain parts of the country and in certain stores, the attempts at whether it's breaking in or whether it's larger scale, just grabbing and running out, that -- those are real, and we are definitely seeing an increase. However, we did not call out material impacts to the business as a result of shrink pressure.

And as we think about -- the way we think about shrink is overarching everything we call shrink as a percent of revenue, right, because you're kind of trying to gauge it versus the volume. And in total, our shrink as a percent of our revenue is within 10 basis points of pre-pandemic fiscal '20. Now

I give our teams all the credit in the world around this. And one of the things that's a little bit different here at Best Buy is given that the high-ticket nature of what we sell, we've been addressing shrink aggressively for, honestly, many, many years. It's really embedded in the culture.

And think about some of the things that are different for us. We have front door asset protection in our stores, and likely often more floor coverage as well because we just have more employees in our stores, and they just do an exceptional job of watching out over our stores. We usually just have 1 entrance in our stores. We tend to have less self-checkout. We have a very high digital penetration at 33%. So that's a little bit different. We also have to spend a lot of time on online fraud, which is a different kind of definition of shrink.

So we just have structurally, I think, a little bit different, and honestly, have been investing really heavily in this space over time, and trying to really harden our buildings, protect our employees and assets. And then as I mentioned, now going into the next realm of technology solutions that are trying to protect the customer experience and make it still seamless for the customers to get everything they want and at the same time, creates the safest possible environment.

Operator

And your final question comes from the line of Brian Nagel from Oppenheimer.

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

My first question, I think it's a bit of a follow-up to Keith's question, just with respect to membership. So Corie, you spent a lot of time on the call today just talking about the ongoing enhancements of membership. And you've given some of the nearer-term financial targets. But I guess the question I want to ask is, as we step back, clearly, this is a big focus for Best Buy. In your minds, what do we play? What's -- I don't want to say necessarily say dream a dream, but the intermediate longer-term opportunity with membership, either from a financial standpoint, more quantifiable or just from an overall consumer engagement standpoint.

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

Yes, I'm going to talk from a consumer engagement lens. The thesis of membership has been consistent since the beginning. It is to drive customer engagement an increased share of wallet in consumer electronics. That is the end game that we're trying to accomplish, all the more important in an environment, where we have plenty of data that says consumers are a little less brand loyal than they've ever been. And so it becomes even more important for us to both create and then maintain this deep relationship with our customers.

What we've learned across, and I said it before, but may hit again, across acquisition, retention and engagement. What we've learned is different customers value and different cohorts of customers value different qualities in our membership program. And so that's why the tiers of Free, Plus and Total they will appeal to either in the free case, someone who just really wants the convenience of free shipping on everything. On the Total -- or on the Plus aspect, excuse me, that's someone who loves convenience at a great value, right? They're going to get the promotions. They're going to get the early access. And we get 60-day return windows. And then on the Total, I want all of that Plus, I really value the support aspect of what we do.

And the most important output of all of those at the end of the day is that we can see customers who both stay engaged with us, and we can see that repeat business. And we can see that increase in share of wallet, meaning every time they think about making a purchase in consumer electronics, they just come to us because it's so easy. Why would you go anywhere else. So that structurally is what you're trying to build. So over time, you both want the program itself to be efficient. You want it to be a reasonable cost of acquisition. But over time, you also want a customer who is shopping with more frequency and ultimately spending more with Best Buy.

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

No, that's very helpful. I appreciate that. And then my follow-up question, different topic. We talked about the sale, the expected sales trajectory through the balance of the fiscal year with the expectation that sales will continue to solidify improve, maybe work towards that flatline. But you also did call out, I think it was in the prepared comments, the risk of it, if you will, is the challenge of this resumption of student loan payment. So it's obvious topic is starting to get more air time. The question I have is, to what extent you look closely at this? And how are you sizing and if you are sizing that potential risk to your sales trajectory here in the near term?

Matthew M. Bilunas - *Best Buy Co., Inc. - Senior Executive VP & Enterprise Strategy & CFO*

Yes. I think it's clearly something we're trying to assess. And what we effectively believe we've tried to size that in our guide for the back half of the year. So it's clearly -- there are a number of different factors influencing the consumer right now, their shift to spend, their services, their increasing use of credit card, but they're still spending money. So I think it's certainly an impact for us. I think if you look at our demographics, we potentially could be more slightly exposed. But at the same time, we have a demographic that actually is a higher income, who can more afford increase in the number of student debt payments. So it's something we've certainly tried to factor into the back half for sure, but it's not the only factor that's happening.

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

You bet. Thank you, Brian. We appreciate the questions. And overarchingly, thank you to everyone who took the time to be with us today. And before we close the call, I want to make sure we acknowledge the wildfires in Maui, but also the wildfires we've seen in Canada and those bracing for a hurricane in Florida. Our hearts genuinely go out to those impacted. And we are doing all we can to support our employees in all of those impacted areas. Thank you so much for joining us today.

Operator

That concludes today's Best Buy Second Quarter fiscal 2024 Earnings Conference Call. Thank you all for joining, and I hope everyone has a great day.

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