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# EDITED TRANSCRIPT

BBY.N - Q3 2021 Best Buy Co Inc Earnings Call

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## OVERVIEW:

Co. reported 3Q21 enterprise revenue of \$11.9b and non-GAAP diluted EPS of \$2.06.

## CORPORATE PARTICIPANTS

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

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

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

**R. Michael Mohan** *Best Buy Co., Inc. - President & COO*

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

**Simeon Ari Gutman** *Morgan Stanley, Research Division - Executive Director*

## PRESENTATION

### Operator

Ladies and gentlemen, thank you for standing by. Welcome to Best Buy's Q3 FY 2021 Earnings 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.

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### 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; Matt Bilunas, our CFO; and Mike Mohan, our President and COO.

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.

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 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 strong Q3 results. Our comparable sales grew a remarkable 23% as we leveraged our unique capabilities, including our supply chain expertise, flexible store operating model and ability to shift quickly to digital, to meet what is clearly elevated demand for products that help customers work, learn, cook, entertain and connect in their homes. We provided customers with multiple options for how, when and where they shop with us to ensure it met their definition of safe retailing.

The current environment has underscored our purpose to enrich lives through technology, and the capabilities we are flexing and strengthening now will benefit us going forward as we execute our strategy. Our team showed empathy, ingenuity and extraordinary execution throughout the quarter.

Best Buy has always had a very strong culture. Over the past several years, we have been pairing that strong culture with a purpose-driven approach, and that is showing up in the way we are responding to the current environment. This pandemic as well the natural disasters and civil unrest of the past several months has been difficult for so many people, physically, financially and emotionally. I am incredibly proud of the way our teammates are helping not only our customers, but each other and their communities.

Customers continue to shop and interact with us differently than pre-pandemic. Online sales increased 174% and comprised 35% of our total Domestic sales, which we view as a testament to our strength as a multichannel retailer. Our interactions with customers via phone and chat were significantly higher than last year. And we continue to evolve our consultation program as our advisers conducted a much higher mix of customer consultations digitally and in stores than last year when consultations were predominantly in customers' homes.

We have seen elevated growth in new customers since the beginning of the pandemic. In Q3, we also saw strong growth in customers we haven't seen in a while who have reengaged with us as well as sales growth from our current engaged customers.

As we shared on our last call, sales were up 20% for the first 3 weeks of the third quarter. Ultimately, as you can see in our results today, our sales growth remained elevated throughout the quarter as we continue to benefit from stay at home and the shift in consumer spending away from areas like travel and dining out. In addition, October included the benefit of our Prime Day-related sales, which shifted out of July this year, and an earlier start to holiday promotions.

From a product category perspective, consistent with last quarter, we saw strong growth across most categories, especially computing and appliances, both large and small. In addition, our home theater category returned to growth and was a significant contributor to our comparable sales increase.

We were experiencing supply constraints as we entered the third quarter, and our teams work closely and effectively with our vendors to bring in as much inventory as possible. While we did see our inventory positions improve through the quarter, we experienced continued inventory constraints in a number of categories, which moderated our sales growth. The high level of global demand simply continued to outstrip supply in a number of categories, particularly large appliances and computing.

Our supply chain team was amazing in moving the sheer volume of product into and across the country. In addition, our speed and quality of product delivery in customer homes improved throughout the quarter, with October showing our fastest ship-to-home stats since the beginning of the pandemic, despite more than 200% growth in online revenue.

From a profitability standpoint, our better-than-expected sales resulted in significant operating income rate expansion and non-GAAP EPS growth of 80% over the same period last year. This strong financial performance is allowing us to share our success with the community, our shareholders and, importantly, our employees.

In the quarter, we made a \$40 million donation to the Best Buy Foundation to accelerate progress toward our goal to reach 100 Teen Tech Centers across the U.S. And today, we announced we are resuming our share repurchase program.

For our employees, during the quarter, we structurally raised our starting wage to \$15 per hour, paid discretionary recognition bonuses to field employees and reinstated our short-term incentive compensation. In addition, in recent weeks, we have resumed our 401(k) employer match and invested significantly in our employee wellbeing strategy. Some examples include expanding our caregiver pay program, so it can now be used to care for in-laws, siblings and grandchildren; expanding our backup childcare benefit, so employees can now use the services of someone they already know and trust; and providing tutoring reimbursement for employees' children.

In the early days of the pandemic, we established an employee hardship fund that continues to provide emergency funds to our employees who are sick, have loved ones who are sick or experiencing financial hardship. As we manage through the pandemic, nothing remains more important to us than the safety of our customers and employees. As you would expect, we follow a variety of safety procedures, including requiring customers and employees to wear face coverings, requiring employees to complete daily wellness checks, frequent cleaning protocols and more. As has been the case throughout the entire pandemic, we are also limiting the number of customers inside our stores to allow for CDC-recommended social distancing.

During the third quarter, customers continued to give us high marks for safe interactions as 97% of those surveyed said we made them feel safe while they were in our stores and while we were in their homes. We are constantly adjusting our operations and piloting experiences that emphasize safety and build on our ability to flexibly respond as the course of the virus changes. For example, we recently extended curbside hours to allow customers to pick up their curbside order prior to store open hours or after store close hours.

Additionally, in almost all stores, while customers are still welcome to come in and shop freely, we have transitioned all store pickup orders to curbside pickup orders. This will help reduce the people in our stores who simply need to pick up their order and will allow more customers inside who want to shop or talk to an expert. And for the much-anticipated gaming console launch earlier this month, we provided our preorder customers who had chosen the store pickup option the ability to schedule a specific time to pick up their product. This resulted in fewer crowds and lines and was hugely successful. Both customers and employees loved it.

Despite the disruption and uncertainty related to the pandemic and our current environment, we remain focused on executing our Building The New Blue strategy. Our current way of life in our homes, reliant on technology, has only reinforced our belief in our strategic direction and purpose. Many of the strategic themes we discussed at our investor update last September have come to life in a very accelerated way over the last year. These can be summed up in the following 3 concepts we believe to be permanent and structural implications of the pandemic.

One, customer shopping behavior will be permanently changed in a way that is even more digital and puts customers entirely in control to shop how they want. Our strategy is to embrace that reality and to lead, not follow. It is too early to know exactly how much of our sales and customer shopping activity will be via digital channels over time. But as a result of the pandemic, we expect it will be higher than it has been historically.

Two, our workforce will need to evolve in a way that meets the needs of customers while providing more flexible opportunities for our people.

And three, technology is playing an even more crucial role in people's lives. And as a result, our purpose to enrich lives through technology has never been more important. Said differently, people are using technology to address their needs in ways they never contemplated before, and we play a vital role in bringing tech to life for both customers and our vendor partners.

These concepts are extensive and interdependent, and we are as quickly as possible both implementing change today and assessing future implications across our business. As you will see, we are taking the opportunity to test and pilot a range of models and initiatives in order to chart the very best path forward. In line with our other strategic priorities, we continue to see opportunity for efficiencies, which will allow us to reinvest in the business and build on our experiential differentiation in the future.

Now I would like to share some examples of the work we are doing as it relates to our stores and labor model, starting with stores. Our stores provide customers the opportunity to see and touch products, ask questions, get advice and receive support. As we have discussed many times, they also serve an important role in the fulfillment of online sales.

We have created what we believe to be an industry-leading store pickup experience that our customers value and now expect from us. So our stores will look different over time in terms of function, size and possibly even quantity, but they remain incredibly valuable and a cornerstone of our strategy.

As we mentioned last quarter, we have started to evolve the way we use our stores for fulfillment. We are pleased with the progress of our 250 ship-from-store hub locations that we first piloted in September. In fact, we are adding about 90 locations for the holiday period. All our source will continue to ship online orders, but these locations are positioned to ship out significantly more volume and utilize dedicated labor aimed at fulfilling orders originating online. These locations require minimal capital investment as we had the technology in place and were chosen due to their available warehouse space and proximity to carrier partners. Our expectation is that these 340 locations will ship more than 70% of our ship-from-store units during Q4. A significant benefit of our hub model is that it allows us to extend the online order cutoff to 8 p.m. for next-day deliveries, enabling more speed to customers.

We are also testing new store formats to test our hypothesis of stores as more primary fulfillment hubs. In 4 Minneapolis locations, we reduced the shoppable square footage to approximately 15,000 square feet from an average of 27,000. The product assortment on the sales floor will still include the primary categories these locations had before the remodel, but the merchandised SKU count will be reduced, focusing on the most popular items. The remodels will result in incremental space for staging product for in-store pickup and to support ship-from-store transactions as well as provide the ability to stage inventory for items that may not be on the sales floor.

In one of the 4 locations, we are utilizing some of the available space to increase the previous allocation to our Geek Squad business. Normally, we would not remodel any stores this close to the holiday season, but we feel it's imperative to move quickly to gain the learnings about how the store format may complement our omnichannel strategy within a particular market. In another store pilot, we are testing the financial return of reorienting the location of the store warehouse to be adjacent to a new covered drive-up curbside experience and lockers.

From a labor operating model, we are working to provide our employees opportunities to learn new skills and have more flexibility in their jobs. During the quarter, we continued to advance our flexible workforce initiative, which allows store employees to become certified to perform tasks outside their primary job function. This initiative helps employees develop their careers by giving them an opportunity to learn new skills to broaden their experience. It also gives team members the ability to earn a different hourly wage depending on the tasks performed and the potential for working additional shifts that otherwise may not have been available in their primary job function. This, in turn, reduces turnover and improved satisfaction.

At the start of November, over half of our associates were eligible to flex into different work zones, and almost 20% of associates were scheduled in more than one department. For example, an associate who is historically a computing specialist could take a shift in the mobile department, either because he or she wanted to change the pace or perhaps we needed extra labor in the department to support a launch; or an associate who wanted additional hours can grab an extra shift making deliveries to customers' homes. In the near future, employees will also be able to easily take shifts in different store locations.

Over time, we believe employees will continue to gain additional skill sets and be able to fulfill multiple roles, which will lead to additional scheduling eligibility and flexibility for them and also drive efficiencies in labor planning and cost. This initiative works in concert with our focus on evolving the way we position employees to serve customers based on need, irrespective of channel. An example of this is the way we are supporting our customers who want to interact with us via phone or online chat instead of coming into a store. As I mentioned earlier, we have seen demand for phone and chat interactions skyrocket during the pandemic.

We have moved quickly to get about 450 dedicated store associates cross-trained to help customers via phone and chat and are skill-setting another 5,000 people to flex into digital sales, if needed, based on demand. These 5,000 people could hop online if the store is slow or be utilized in high-volume periods during the holiday. We are looking to utilize this faster in Thanksgiving as our stores will be closed this year. In addition to phone and online chat, we have just added the ability for customers to launch a live video chat with one of these store sales associates from the comfort and safety of their own home.

As it relates to our customer consultation program, our advisers continue to leverage their flexibility and skill set in meeting customer demand, whether that is digitally, in our stores or in homes. While the majority of consultations are still in customers' homes, the number of digital consultations is becoming a meaningful percentage of the mix. As we improve the technology and experience for digital interactions, it opens up the opportunity for our advisers to reach even more customers.

Fundamentally, our strategy and competitive advantage depends heavily on our people and the differentiated service we provide our customers. It is true that due to rapidly evolving operating models and escalating demand in the first half of the year, we saw considerable leverage on lower labor costs. We learned a lot, some of which will inform ongoing leverage and efficiencies. We also learned what may not be sustainable for our strategy and the experience we want to provide our customers. We are both implementing change and piloting tests that will define our long-term working model, balancing our customer experience expectations and efficiencies.

As you can see, we have been examining our business model from top to bottom to determine where we may be able to accelerate our strategic efforts. We have also reviewed areas where we might scale back. Importantly, we viewed it as critical that the outcome of this analysis would ensure our focus and resources are closely aligned with the opportunities we see in front of us. As a result, during the quarter, we made the difficult decision to exit our operations in Mexico. I want to thank the teams in Mexico for their tremendous work over the past several years. They should all be incredibly proud of their accomplishments.

Now let's talk about holiday. 2020 has truly been a year unlike any other, and that's certainly true for this year's holiday shopping season. First, we launched our Black Friday deals earlier than ever in mid-October and have had several other sales events since that time. We started these events early and spread them over the course of several weeks to help avoid overly crowded days in our stores in order to create a safer shopping experience. We also decided to close our stores on Thanksgiving day.

In addition to our existing in-store safety measures, we have added a digital queue for customers who are waiting for assistance from an employee so they can socially distance outside in their cars or within the store while they wait. And we now have a dedicated customer experience host at every store to help guide shoppers, answer questions and manage any lines. We have also extended our store hours to close at 8 p.m. from 6:00 p.m. And similar to prior years, we'll add additional hours as we move through the holiday season.

Meanwhile, customers who shop online now have more choices for how to get their order. Contactless curbside pickup is available at all of our stores. Online customers using our app to pick up their orders can plan their trip by viewing high and low traffic times. With first-time launches of our app up 40% in Q3 compared to last year, customers are using the app more than ever, and it is increasingly becoming a great self-help tool in addition to a compelling shopping experience.

Of course, our online customers can also choose next-day or same-day delivery. In addition to our diverse network of third-party partners, we expect to have about 450 stores set up with dedicated labor and vehicles so that our own Best Buy employees can make deliveries to our customers. Almost all Best Buy stores now offer same-day delivery on thousands of products. If the customer places an order by 1 p.m. local time, they'll get it by 9 p.m.

Before I conclude my prepared remarks, I want to update you on our ongoing commitment to inclusion and diversity in our community. As we've discussed before, we are committed to doing all that we can to further economic and social justice in our communities. This effort takes form in several ways, including our signature Teen Tech Centers. Currently, we have more than 30 of these locations, each of which typically operate year-round in service of hundreds of teens, helping them learn the technology skills necessary to be successful in the modern economy.

The data on this effort is clear: we are making a measurable difference in the lives of teens who might not otherwise have this chance. By the end of 2025, we will have more than 100 of these Teen Tech Centers, serving more than 30,000 teens a year. In a related effort, we are also dedicating sizable resources to scholarships with historically black colleges and universities around the country that will, of course, be available to our Teen Tech Center graduates.

At the same time, we are looking to do more closer to home and are proud to announce that going forward, we plan to have 1 out of 3 non-hourly open corporate positions filled by someone who is black, indigenous or a person of color. In the field, we also plan to have 1 out of 3 non-hourly

open roles filled by women. At the same time, our intention is to create, over the next few years, parity and retention rates among all of these groups. In support of these initiatives, we have transferred \$40 million in Q3 to the Best Buy Foundation. The senior leadership team and I are proud of the work our company has done on these initiatives and are pleased we could increase funding on this onetime basis in support of our efforts.

Earlier this month, we helped empower our employees to vote by opening our stores at noon local time on election day to ensure our store employees had the time they needed to cast a ballot in person if they chose to do so. We also gave paid time off to employees who volunteered to work at the polls on election day.

We also remain committed to our broader environmental, social and corporate governance efforts, including those related to sustainability. To that end, we recently signed The Climate Pledge, a commitment to be carbon neutral across our business by 2040, a decade faster than our previous goal of 2050. This commitment is supported by the recent completion of our second solar field investment.

In conclusion, we delivered very strong Q3 financial results. We are executing well and clearly benefiting from the need for people to connect, work, learn, cook and entertain at home. Throughout the pandemic, we have been confident that we will emerge an even stronger company than we were before.

In the near term, of course, much uncertainty still remains around the depth and duration of the pandemic as well as economic impacts of sustained high unemployment rates. We continue to be encouraged by our clarity of purpose and our momentum, which is guided and will continue to guide our operating model changes and investments. Our purpose to enrich lives through technology is more relevant than it has ever been. And we are confident regarding our execution, adaptability and the opportunities ahead.

In many ways, our response to the impacts of the pandemic has allowed us to accelerate our strategy. And there remain many aspects of the strategy that require investment to remain relevant with customers in this very competitive omnichannel environment, such as our digital experience, supply chain and critically important in-store and in-home associates. In fact, having the foresight to invest in these omnichannel experiences for the past several years was essential in delivering our results during this pandemic. We will continue to invest in those capabilities that focus on the customer experience over the long term and that are designed to provide choice, speed and now safety.

Now I would like to turn the call over to Matt for more details on our Q3 financial results.

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

Good morning. The demand for our products and services has remained incredibly strong for the past several months, and our Q3 sales were better than our expectations. As Corie highlighted, technology has taken on an increased importance in all of our lives. And while we are clearly seeing sales growth from consumers looking for ways to navigate through the pandemic, the fundamental reliance on technology has also grown and strengthened our purpose.

On enterprise revenue of \$11.9 billion, we delivered non-GAAP diluted earnings per share of \$2.06 or an increase of 82% versus last year. Our non-GAAP operating income rate of 6.1% increased 190 basis points as we saw leverage from the higher sales volume on our fixed expenses. This was partially offset by a 30 basis point decline in our gross profit rate.

In our Domestic segment, revenue for the total quarter increased 21% to \$10.9 billion. The increase was driven by comparable sales growth of 23%, which was partially offset by the loss of revenue from stores that were permanently closed in the past year as part of our normal course of business. As Corie mentioned, October included the benefit of our Prime Day-related sales, which shifted out of July this year, and an earlier start to holiday promotions. This helped push October comp sales up to 33%, our highest monthly comparable sales growth of the quarter.

From a merchandising perspective, we saw broad-based strength across most of our categories with the largest comparable growth coming from computing, home theater and appliances. This growth was partially offset by a decline in the mobile phone category. In addition, comparable sales in our services category grew 13% during the third quarter. Similar to the broad-based strength in our product categories, our services category had positive revenue growth from both Total Tech Support and our warranty business.

In our International segment, revenue increased 25% to \$1 billion. The increase was driven by a comparable sales growth of 27%, which was partially offset by 140 basis points of negative foreign currency impact. The growth was primarily driven by Canada, where we experienced similar trends as our Domestic segment from a consumer demand standpoint.

Turning now to gross profit. The domestic gross profit rate declined 30 basis points to 24%. The decrease was primarily driven by supply chain costs associated with higher mix of online revenue. As Corie noted, our online sales were 35% of our overall Domestic sales in the quarter, which compared to 16% last year. We also saw lower profit-sharing revenue from our private-label and co-branded credit card arrangement. These pressures were partially offset by a promotional environment that was more favorable compared to both last year and our expectations going into the quarter.

Our International non-GAAP gross profit rate increased 10 basis points to 22.6%, primarily due to a less promotional environment, partially offset by increased supply chain costs from a higher mix of online sales.

Moving to SG&A. Domestic non-GAAP SG&A increased \$146 million compared to last year and, as a percentage of revenue, decreased 210 basis points. On our last call, we shared our expectation that SG&A dollars in Q3 would be similar to the prior year. The largest drivers of the expense increase versus last year were also the areas that were higher than our expectations at the start of the quarter. These were: one, higher incentive compensation for corporate and field employees of approximately \$75 million; two, increased variable costs associated with the higher sales volume, which included items such as credit card processing fees; and three, the \$40 million donation to the Best Buy Foundation. These increased expenses were partially offset by lower store payroll expense.

Let me share a little additional color on the lower store payroll expense, which was driven by a fewer labor hours for our associates. This was primarily due to lower store revenue, our reduced store operating hours and efficiencies in our labor model, which were partially offset by additional hours needed to support the fulfillment of online orders. This decline in labor hours was partially offset by higher hourly wage rates as the increase in our starting wage to \$15 an hour went into effect at the start of Q3.

I would point out that although our Q3 store channel revenue was down approximately 8% to last year, when including the online revenue for store and curbside pickup and ship-from-store, the revenue supported by our stores' labor actually increased on a year-over-year basis. On our last earnings call, we shared that about 2/3 of our original 51,000 furloughed employees had returned to work. Any remaining employees that had been on furlough were asked to return to work as seasonal employees for the holidays.

Let me next provide more context on the restructuring charges from this quarter. As Corie mentioned, we made the decision during the quarter to close down operations in Mexico. In our Domestic segment, we also took actions to more broadly align our corporate organizational structure in support of our strategy. As a result of these decisions, we incurred approximately \$111 million in restructuring charges and an additional \$36 million of inventory markdowns in Mexico that were excluded from our non-GAAP results. For context, on our Mexico business, its fiscal '20 annual revenue was approximately \$400 million with slightly negative operating income.

Moving to the balance sheet. We ended the quarter with \$5.7 billion in cash and short-term investments. In the third quarter, we completed a public bond offering for \$650 million in 1.95% notes due in October 2030. The net proceeds from the sales will be used to replace the \$650 million in 5.5% notes that mature in March 2021, which we expect to retire during Q4 by exercising the par call.

At the end of Q3, our inventory balance was approximately 1.5% lower than last year's comparable period, whereas our accounts payable balance increased 26%. We entered the third -- entered the quarter with inventory down 21% to last year. And although trends progressively improved throughout the quarter, as Corie stated, we still experienced constraints driven by the high demand in several of our key categories.

Our capital allocation strategy remains the same. We will first reinvest in the business to drive growth and remain committed to being a premium dividend payer. We will then look to return excess cash to shareholders through share repurchases. During the third quarter, we paid \$142 million in dividends. We suspended share repurchases last March in order to conserve liquidity in light of the COVID-related uncertainties, but we now plan to resume share repurchases this month. We anticipate the level of share repurchases in Q4 to be similar to last year's comparable quarter.



As we look to next year, assuming business trends remain favorable, we would expect to spend a higher amount on share repurchases than we have in more recent fiscal years. From a capital expenditure standpoint, we now expect to spend approximately \$725 million during fiscal '21.

Lastly, let me finish by sharing a few comments about the fourth quarter. As a result of the ongoing uncertainty, we are not providing financial guidance today. However, I would like to provide some insight into how we are thinking about Q4.

As we start the fourth quarter, the demand for the products and services we sell remains at elevated levels, but similar to last quarter, it continues to be difficult for us to predict how sustainable these trends will be. In fact, we are seeing COVID cases surge throughout the U.S. and Canada at a time of significant holiday volume through our stores, online and supply chain. There continue to be other factors to consider, such as potential future government stimulus actions, the current shift in personal consumption expenditures from areas like travel and dining out, the risk of continued higher unemployment and the availability of inventory to match customer demand.

From a revenue standpoint, we believe our Q4 sales growth will be positive, but we don't expect sales trends to remain at the levels we experienced during Q3. While our sales in the first few weeks of November have remained strong, they include the launch of the new gaming consoles from Sony and Microsoft and also likely a pull-forward of sales from later in the holiday season. In addition, inventory constraints are expected to continue in certain key categories.

We anticipate that our group Q4 gross profit rate will continue to be pressured, and we expect the year-over-year rate decline in Q4 to be higher than it was in Q3. This is due to an expectation that a higher mix of online sales will continue to drive higher supply chain costs, including the increased parcel surcharges from our carrier partners. In addition, we anticipate a higher sales mix from lower-margin gaming consoles to negatively impact our rate. As it relates to the promotional environment, while we expect to see continued favorability on a year-over-year basis, we expect it to be less of a tailwind than it has been in the first 3 quarters of this year.

We expect our Q4 SG&A dollars versus the prior year to increase as a percentage in the mid to high single-digit range. The increase in SG&A is expected to be driven by incentive compensation, increased variable costs from the higher expected sales and investments in both our health business and in technology. We expect these increases to be partially offset by slightly lower store payroll expense.

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

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) Our first question comes from Karen Short of Barclays.

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**Karen Fiona Short** - Barclays Bank PLC, Research Division - Research Analyst

I wanted to just follow up on your last comments there. I think in 2Q, you had commented that the second half would potentially benefit from a lower or less promotional environment on the gross margin front. So wondering if you could talk a little bit about that as you look to 4Q, given the comments you just made on the gross margin.

And then also, wondering if you could just give very high-level puts and takes as we look to '21 because, obviously, there's so many moving parts on both the gross margin and the SG&A side. So if you could just give high-level comments on how we should think about both of those into '21, that would be helpful.

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

Sure. So for promotions, Q3 was definitely less promotional than last year, but a little bit more than we saw earlier in the year due in part to the earlier start to the holiday, which occurred in October. Due to the continued demand for products and industry-wide inventory strains, it's -- we're still seeing promotionality be less on a year-over-year basis. Our assumption would be that in Q4, promotionality increases a bit relative to Q3. But considering the elevated level of demand and continued constraints in some areas of inventory, we don't expect it to be a year-over-year pressure.

So looking into next year, from a cost perspective, from a margin and SG&A, I think it's a bit early to know exactly how that manifests next year. We're clearly going to be looking at next year quarter-by-quarter. Every quarter of this year was a bit different than the others. And so as we enter next year, it's likely that the trends that we're seeing continue on from a demand perspective, at least on the start. And so we'll look at the early part of the year a little differently probably than the rest, and we'll obviously remain competitive from a pricing perspective throughout the year. But we'll also look to leverage the efficiencies and the learnings we've made this year in terms of the SG&A structure.

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**Operator**

Our next question comes from Simeon Gutman with Morgan Stanley.

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**Simeon Ari Gutman** - *Morgan Stanley, Research Division - Executive Director*

My question, I'll make it in 2 parts. Maybe first for Corie, thinking about the margin structure of the business over the medium term. I think you outlined all of those steps you're taking and the experimentation with the stores and the different labor models. I'm wondering, are you doing that because you think the margin of the business could end up north of that non-GAAP goal of 5%? Or are these changes to -- in order to uphold it?

And then just the second question is, I think Matt mentioned, look, we still expect comp store sales to be positive for the fourth quarter. I think that -- I think a lot of us expect that. But given some of the pull-forward that you're seeing today, is there any reason we should see a sharp slowdown? And do you have a sense of how much that pull-forward is affecting the business, given how early some of the Black Friday sales have started?

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

Simeon, as we go back to the update that we provided last year, you could hear it in the remarks, we feel like the strategy is spot on and, in fact, more relevant than ever. And obviously, the proliferation of consumer electronics is as high as it's ever been. People are just getting more comfortable using connected devices and living a connected life, frankly, across their home. Obviously, you can appreciate we're not going to update the financial targets.

I think what we would say is in the many ways we're ahead of where we thought we would be at this time, we've accelerated a massive amount of learnings and investments. And I think you'd also argue, many retailers are ahead of where they thought they'd be at this time. I think right now, we believe that's all the more reason we need to double down on what makes us unique. Therefore, we're testing, we're learning and then probably have some suite of investing to do once we understand better the results of those tests and those hypotheses.

What's most important and what remains most important is building those fundamentally sound relationships with our customers that keeps us relevant and in their consideration set over time. And so we will continue to make investments around technology, stores, membership. Could we see an EBIT rate higher than the 5% we laid out? Maybe, but that's not the goal. The goal right now is to figure out how customers are shopping differently and, therefore, the role we need to play to build those foundationally sound relationships over time.

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

And maybe from a Q3, a pull-forward question that you had, I think, clearly, we outlined October sales benefited from an earlier start to the holiday season. It also benefited from a shift of Prime Day from July into October. It's really difficult to predict exactly how much was pulled into Q3 from

Q4, but there are a few considerations. We talked about October being 33% growth in the month. We also talked about the start of the quarter, it was about 20% growth in the first few weeks.

So clearly, with the elevated level of demand in October, it clearly points to a period in between those 2 that is around 20% or slightly lower. So that's why when we look at Q4, we don't necessarily expect the trend of Q4 to continue on at that Q3 pace. Although we wouldn't necessarily say we're signaling sharp declines, we're just very thoughtful about the rest of the quarter coming and that we're pulling sales further into October and in November, and we have some pretty significant days ahead in terms of Thanksgiving day being closed, but also cyber week and the week before Christmas. So just a lot of factors still to think through.

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**Operator**

Our next question comes from Brad Thomas with KeyBanc Capital Markets.

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**Bradley Bingham Thomas** - *KeyBanc Capital Markets Inc., Research Division - Director and Equity Research Analyst*

A question on inventory. Could you talk a little bit more about where you're seeing shortages? Maybe how much do you think that hurt you in 3Q? And how much it might hurt you in 4Q? And when you think the supply chain may start to catch up with the strong demand?

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**R. Michael Mohan** - *Best Buy Co., Inc. - President & COO*

Brad, thanks for the question. As we announced in our prepared remarks, we started the quarter with inventory down pretty significantly versus prior year, at least matched against our sales trends. And the team, and I just need to call it out, did remarkable work. We see more merchandise in our fiscal third quarter than, I think, in the history of Best Buy, which is a feat in itself. The pressures are still in the long lead time categories. Domestically, major appliances saw impacts both on inconsistent demand and then factories shutting down for COVID-related issues. And clearly, there is consumer demand with the housing market that we see as a long-tail play. We're excited about being back into the inventory position we need, but we think it's going to remain constrained probably into early next year.

The demand in computing has been sustained right since the start of the COVID crisis. And right in the middle of the crisis, we had a back-to-school event. Normally, you guys would be asking questions about our back-to-school season. It's been back-to-school or back to work-at-home or back to educating-at-home since March. We're really happy with the supply chain model there. We have great relationships with all of the world's top OEMs, and we work with them literally every day to fulfill the needs. But I think we're going to be -- we'll be tighter there than we would appreciate, but it will be enough inventory to support our sales.

As we transition into next year, I don't see any long-tail things. There's some real constraints, obviously, as part of what we're saying, on the new gaming consoles. And that will probably be sustained through the holiday season, but they're a long product cycle, and I see us getting in a good position fairly quickly after the holiday. Thanks for the question.

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**Operator**

Our next question comes from Greg Melich with Evercore ISI.

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

My question was about the one area that was down in the quarter, mobile phones. Just curious if that is simply a function of the delay of the iPhone versus a year ago or is there something else there in terms of replacement cycles that you're seeing in consumer demand?

**R. Michael Mohan** - *Best Buy Co., Inc. - President & COO*

Hey, Greg, thanks for that question. I think you've kind of hit it on the head. There has been a year-over-year change on when new products were launched versus when they were in 2019. That's probably the biggest transition that you have to think about. What we're excited about is on the new devices, the demand for the higher capacity, larger screen and the phones that are purely ready to be 5G-enabled are quite good, and the vast majority of the products we are selling are actually 5G-enabled.

So we like the demand signals going into what the new devices will look like. I think the replacement cycle on phones has been forever changed. And so the role we will play will continually help customers who are seeking out the newest technology to get the best out of their experience, and that's what we're excited about going forward.

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

And then a follow-up to the same question is on services. How many new customers did you get in Total Tech Services and Home Advisor? You mentioned you had more. So if you could give us a number, that would be great.

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

Yes. For Total Tech Support, we did grow the member count after holding pretty steady in the first half of the year. We haven't been updating that number quarterly, and we're not going to now. But for reference, the last we shared was about 2.3 million members at the end of fiscal '20. We definitely saw usage of the remote support offering continue to increase during the pandemic, and we also saw improved trends compared to earlier in the year as it relates to things like installation and repair. And we expect that usage to continue to ramp up as the stores are fully open and we're back in homes providing the more fulsome suite of services. And to underscore what Mike said, I have to give our teams a ton of credit for the work that they have done to creatively find ways to help our customers who, in some cases, are pretty desperate to make sure their devices are working together.

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**Operator**

Our next question comes from Scot Ciccarelli with RBC Capital Markets.

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**Robert Scot Ciccarelli** - *RBC Capital Markets, Research Division - MD & Consumer Discretionary Sector Analyst*

I wanted to ask about some of the changes to the operating model just in terms of shrinking your physical space and some of the shifts you've made to the labor model. And I guess what I'm wondering is if the shift resulted in lower sales, so lower market share but higher returns and profitability, is that a win? Or is that a go-forward strategy? Or do you have to win on both of those fronts?

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

Yes. Thanks for the question, Scot. I -- the point of -- so there's kind of 2 different subjects here. One is a very small test that we're doing right now, 4 stores around square footage. And it's more about stores as a real fulfillment hub that can act as a convenient and easy place for our customers to come and get what they want and both a more limited SKU assortment that is merchandised, but frankly, a wide assortment that's available for pickup in the store as well as some services. That's really early. It's small and we're learning.

On what we're trying to achieve with our operating model changes, it's interesting. What we're actually trying to achieve is a better customer experience at the end of the day that is enabled through a more flexible and more educated workforce. And the idea in that, the win is actually that we can provide more flexible expertise across the store that you might have one teammate who can work with you across the entire store that we developed the best-in-class curbside and in-store pickup capabilities, but the concept is not about pullout as much cost as possible. The

concept is about creating a workforce that is more flexible and can be used across departments and, frankly, across customer needs. So it's not quite clunky moving around in the store. Success then is actually, you have a more fulsome in-store experience and your associates have the ability to garner more skills to opt into more flexible schedules and to be able to, potentially, at some point, then move between stores, depending on their availability.

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**Robert Scot Ciccarelli** - RBC Capital Markets, Research Division - MD & Consumer Discretionary Sector Analyst

So if we would characterize it as more qualitative rather than quantitative in terms of the scorecard.

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

I think it's both, honestly, Scot. So I mean Matt hit on in his prepared remarks, there are some efficiencies that you're able to build in, in terms of hours. But again, that's not the goal in and of itself. The goal is to provide more seamless customer experiences, better employee experiences that actually then continue to create that relationship over time, which also is a quantitative measure. It's just that it's more of a quantitative measure over time.

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**Operator**

Our next question comes from Mike Baker with D.A. Davidson.

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**Michael Allen Baker** - D.A. Davidson & Co., Research Division - MD & Senior Research Analyst

So a product-related question, but 2 parts, if I could. First, an update on your health care initiative, which really hasn't come up too much in this call. Can you talk about products in the GreatCall business and then also where you are on the commercial side of that as the pandemic slowed down discussions with insurance companies?

And then the second product question is on gaming. So you said consoles, there's some concern that, that was strong in October and will that continue -- excuse the dog in the background. My question is, will that continue into the fourth quarter as well? In other words, should gaming consoles also be very strong in the fourth quarter? And so why would that slow down?

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

Absolutely. I'll start with some color around the health business. I think it's obvious, but it bears repeating. What we're living through right now with the pandemic completely underscores our strategy and what we're trying to do, and that is to help seniors live more independently with the help of technology. I think we do that through this unique combination of technology and touch and our ability to both have the right products, to your point, but also have the services wrapper cycle around it.

The consumer business was impacted earlier in the pandemic with the closure of the stores. Obviously, we sell a lot of those devices through the stores where you have a chance to really interact with the customer and explain the unique capabilities of those products. Obviously, as we've opened the stores more broadly, those trends have improved materially. And we're definitely seeing that kind of GreatCall consumer side of the business ramp-up.

There's also just a question of broader health and fitness kind of writ large. And again, you would probably know it from your own life, there are more people using technology devices. Whether it's at-home fitness, whether it's monitoring and tracking your own fitness, there are more people using those devices. So we continue to like our positioning in the kind of broader health and fitness arena beyond just the kind of aging side of things.

And then, obviously, we continue to work on our relationships on the commercial side of the business where we work directly with the payers and providers. There continues to be significant interest. But you can imagine, there's a lot going on, on that side of the business, just given the pandemic that we're working through. But the adoption of things like telehealth, the ability and, frankly, pull from consumers to use more tools like that only underscores the potential in that market, we believe, from here.

Mike, maybe you want to comment on gaming?

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**R. Michael Mohan** - *Best Buy Co., Inc. - President & COO*

Yes, certainly. Mike, good question on gaming. I think maybe just some clarification. In Q3, we didn't call it out specifically, but the gaming category had growth, but it's driven from legacy devices, primarily products from Nintendo peripherals and accessories. As we moved into Q4, the 2 new console launches from Microsoft and Sony are off to a great start, and they're reflected in the comments that Matt had to start the quarter.

I think the only thing I'm giving perspective on is they're going to be constrained through the quarter, and there'll be more demand than there will be devices, which has been sort of a reoccurring occurrence every 6 or 7 years. This year, it's more heightened because more people, I think, than ever need something to do with their families at home.

What we're excited about is the customer experience steps we took to create the best experience on something constrained. These are 2 world-class partners, but bless their hearts, they didn't do us any favors the way they launched products. And so when we had preorder demand, we set up everything from how you queue for it, how you booked an appointment so you wouldn't wait in line when you got your products.

And as we get additional inventory during the holiday season, we're releasing it in a way that you can find it on bestbuy.com and our digital channels. And you can actually get it as a customer. We're trying to protect the experience, so people who are trying to buy it and resell it or bought can't get through our site as easily as perhaps other places. It's a lot of work our technology and customer experience and operations teams are doing, but our goal is to get as many of these products into consumers' hands to delight them.

What we can't tell you is how many we'll sell because I actually don't know how many we're going to get, and that's probably indicative of everybody else you guys cover. I think the long tail on this is going to be pretty strong given the fact people want these devices at home. And the early signs on people who are buying them from Best Buy are new customers to us, slightly younger, and we're excited about their ability to come back and visit us for peripherals and accessories, too. I hope that helps, Mike.

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**Michael Allen Baker** - *D.A. Davidson & Co., Research Division - MD & Senior Research Analyst*

That does.

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**Operator**

Our next question comes from Seth Basham with Wedbush.

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

My question is around the store model test that you're doing, first, in Minneapolis and then, secondly, with the pilot of the warehouse adjacent or the drive-up. Can you give us some color as to the timing associated with measuring the ROI on that and the potential for rolling that out in 2021 to a broader group of stores?

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

I think we're going to need to give this one a little bit of time. Obviously, and we said it in the remarks, this is about a market working together to serve customers in the most effective way possible. And so this is the very first foray into fulfillment stores like this. And my guess -- not my guess, I know we will continue to try additional formats and additional ways that we will approach the market as we head into next year.

And so we'll keep you apprised as we learn more, but we definitely want to give this one enough time, especially in a pandemic world where operations are different than what steady state might look like over time. So we are urgent with it, but at the same time, we want to make sure we give it enough time so that we capture as many learnings as possible in this real market-tailored approach.

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

Got it. Just to clarify, enough time, is that a 6- or 12-month type time frame that you're measuring or even longer?

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

I don't see it being something that looks like 3 years, certainly. And I think a little bit of this depends on how the business normalizes back through the pandemic through some of the economic implications. So it's not just about the time line we set. It's also about making sure that we feel like we're getting accurate and real results for where the business is going to go from here.

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**Operator**

Our next question comes from Curtis Nagle with Bank of America.

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**Curtis Smyser Nagle** - *BofA Merrill Lynch, Research Division - VP*

Maybe just following up on Mike's question on gaming and just kind of how to think about what that business looks like for the rest of the quarter. Clearly, demand for these new consoles is how to control good, although I think basically sold out at this point. So I guess with those consoles, at least in kind of very limited stocks, do you think that suppresses demand? Or do you think that just -- look, this is a category that people are obviously very into now and maybe a hot gifting category and things remain good. How do you think about that going through the rest of 4Q?

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**R. Michael Mohan** - *Best Buy Co., Inc. - President & COO*

Curt, I'll start. I think it's a good question, and it's not an easy one to give you an answer other than the category itself and the desire for people to entertain their families and themselves with gaming-type solutions is extremely strong, and that's applicable to things that are constrained like the new consoles from Sony and Microsoft. But we're still seeing incredibly strong demand for all the legacy products that you could argue had been in the market for 1.5 years to 2 years.

And what I think you're going to see is, as allocations continue to improve, we've always focused on the customer experience and execution of making sure those who need these devices get them as fast as possible. That usually turns into the ability for us to get more products sooner, but this is one of those items that are hard to predict. I don't think you're going to see this pull any drag on demand. I think it will be the highest-demand item for this holiday, and we're going to work our best to get our unfair share of allocation to take care of as many customers as possible.

Corie, would you have anything else on this?

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

No, that was perfect.

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**Curtis Smyser Nagle** - BofA Merrill Lynch, Research Division - VP

Okay. And then maybe just one other quick one, one other quick category question. Just thinking about health and exercise equipments, it's something I think you guys have focused on a little bit more this year for obvious reasons. How is it performing? How do you think that category looks through the holiday and next year? Is that an area of, I guess, continued expansion?

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**R. Michael Mohan** - Best Buy Co., Inc. - President & COO

That is another great question. We're excited about the category. And we talked about it a couple of quarters ago, rolling out some products to our stores as the pandemic has started. As we think about the ability to communicate to consumers in this digital-first world, we're more excited right now about expanding the assortment and working on logistics of getting some of these bigger products into people's homes, helping them get set up and, in some cases, getting stuff out of their homes. That's one of the big pain points people are seeing.

I think we've got some excitement in the space, not just for this quarter, but as it moves forward into next year. And I think it's applicable to all these other kind of consumer connected health products that you might think of them as simply as a watch or the Fitbit that you're wearing today. But as you start to put them in concert with other devices that help you live a healthier lifestyle, we're working really hard to help show customers the various options and solutions you can get with a complete suite of things to help with your fitness and wellness needs. So we're very excited about the category.

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**Operator**

Our next question comes from Scott Mushkin with R5 Capital.

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**Scott Andrew Mushkin** - R5 Capital Ltd - Founder & CEO

So I was just wondering if you could talk about how you guys are thinking about next year as you're trying to comp this comp, what you can do to make it easier to go over?

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

Sure. I'll start, and then Corie or Mike can jump in. I think overarchingly, and Corie kind of said this a little earlier, I think it's far too early for us to really comment on sales next year. Right now, we're very, very focused on helping our customers meet their demand right now with a premium on safety for both them and our employees. So that's our first objective right now.

I think there's still going to be a lot of factors for us to weigh as we move into the beginning of next year. Certainly, there is a continuation of elevated demand for things to work and learn and cook and entertain for home. And it's likely that some of that continues on as we go into the beginning of next year, but may start to subside a bit. There's still a heightened level of unemployment right now and likely to continue into next year as well. And clearly, we're not totally sure on how the vaccine starts to get distributed out to everyone.

So there's a lot of factors that we're continuing to weigh in, which is primarily, too, as well, we have a whole holiday quarter ahead of us. And so we've got to see how that shakes out in addition to that. So I think what we can see, like I said earlier, is I think we'll -- these elevated trends will likely continue a bit as we go into next year. But we'll likely have to take each quarter individually and look at the demand trends that we saw this year and trying to understand what they look like next year.



I think, fundamentally, we are seeing the role of technology only intensify in people's lives. We've said this before. I think it's really proliferated. We proliferated the devices in people's homes, and those devices need to continue to be supported. Those devices needed additional advancement in innovation as we go forward. And so we see a lot of opportunities ahead of us. Each quarter will present its own unique challenges, and we'll work through that, and we'll give more update on next year as we get towards the end of the year.

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**Scott Andrew Mushkin** - *R5 Capital Ltd - Founder & CEO*

And kind of along that line, how are you thinking about the inflation, both from a product perspective and also from a wage perspective? And then I'll yield.

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

Sure. Maybe starting with the wage perspective, we -- this year, we clearly went to move to \$15 an hour with our associates in our stores. And so we'll continue to approach increases based on our merit processes as we go forward. So we take a fairly large step forward this year in terms of setting our minimum wage to \$15 an hour. So from a wage perspective, we feel like we're very competitive with the wage and all the other benefits that we offer our associates. From a macro perspective, a little early to know exactly how inflation takes hold next year. There's always some level that we're factoring in. But overarchingly, it's not something that we are too worried about at this point.

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

I think structurally, what the team has done an excellent job with is investing in our employees and then finding ways for us to meet the customer needs in the most flexible way possible. I think about this kind of like as efficiencies that are in service of the customer. So whatever the inflation kind of environment looks like, what we're focused on is making sure we find the balance between what we need to do for our people and how we can best operate the business.

And so with that, I'm going to end where we started. I want to thank all of our customers, our employees for the amazing work that they've been doing and the effort that they've put forth through really incredibly different and challenging times. And thank you to all of you for joining us today. We hope you have a safe and happy holiday.

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**Operator**

Thank you. Ladies and gentlemen, this concludes today's teleconference. You may now disconnect.

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