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# EDITED TRANSCRIPT

TGT.N - Q2 2024 Target Corp Earnings Call

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## OVERVIEW:

Company Summary

## CORPORATE PARTICIPANTS

**John Hulbert** *Target Corp - Vice President - Investor Relations*

**Brian Cornell** *Target Corp - Chair and Chief Executive Officer*

**Rick Gomez** *Target Corp - Executive Vice President, Chief Commercial Officer*

**Michael Fiddelke** *Target Corp - Executive Vice President, Chief Financial Officer, Chief Operating Officer*

## CONFERENCE CALL PARTICIPANTS

**Kate McShane** *Goldman Sachs & Company, Inc. - Analyst*

**Rupesh Parikh** *Oppenheimer & Co. Inc. - Analyst*

**Chris Horvers** *J.P. Morgan Securities LLC - Analyst*

**Simeon Gutman** *Morgan Stanley Co. LLC - Analyst*

**Robbie Ohmes** *BofA Global Research (US) - Analyst*

**Ed Kelly** *Wells Fargo Securities, LLC - Analyst*

**Corey Tarlowe** *Jefferies LLC - Analyst*

## PRESENTATION

### Operator

(audio in progress) Corporation Second Quarter Earnings Release Conference Call. (Operator Instructions) As a reminder, this conference is being recorded, Wednesday, August 21, 2024.

I would now like to turn the conference over to Mr. John Hulbert, Vice President, Investor Relations. Please go ahead, sir.

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### John Hulbert - Target Corp - Vice President - Investor Relations

Good morning, everyone, and thank you for joining us on our second quarter 2024 earnings conference call. On the line with me today are Brian Cornell, Chair and Chief Executive Officer; Rick Gomez, Chief Commercial Officer; and Michael Fiddelke, Chief Operating Officer and Chief Financial Officer.

In a few moments, Brian, Rick and Michael will provide their insights on our second quarter performance, along with our outlook and priorities for the third quarter and remainder of the year. Following their remarks, we'll open the phone lines for a question-and-answer session. This morning, we're joined on this conference call by investors and others who will be listening to our comments via webcast. Following the call, Michael and I will be available to answer your follow-up questions.

And finally, as a reminder, any forward-looking statements that we make this morning are subject to risks and uncertainties, including those described in this morning's earnings press release and in our most recently filed 10-K. Also in these remarks, we refer to non-GAAP financial measures, including adjusted earnings per share. Reconciliations of all non-GAAP numbers to the most directly comparable GAAP number are included in this morning's press release, which is posted on our Investor Relations website.

With that, I'll turn it over to Brian for his thoughts on the second quarter and his priorities for the third quarter and beyond. Brian?

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**Brian Cornell** - Target Corp - Chair and Chief Executive Officer

Thanks, John, and good morning, everyone. I'd like to start my remarks today by welcoming Rick Gomez to this call, following his recent move into the role of Chief Commercial Officer. This change was one of several we announced in June, including Christina Hennington's move into the role of Chief Strategy and Growth Officer, and Lisa Roath's transition into the role of Chief Merchandising Officer of Food, Essentials and Beauty.

Lisa has done a fantastic job leading our marketing team and I've asked her to remain in that role until early 2025. This will provide adequate time for us to complete an external search for her successor before Lisa brings her impressive commercial leadership experience back into the merchandising team. These changes follow our January announcement that Michael would move into the pivotal role of our Chief Operating Officer. Michael took on the CFO role just before the pandemic, and he's done an outstanding job leading the company through a period of unprecedented growth and volatility.

The search for Michael replacement as CFO is ongoing, and I share Michael's excitement for the time when he is able to fully focus on his new role leading all of our operational functions. And of course, we were pleased this month to welcome Amy Tu into the role of Chief Legal and Compliance Officer. During her career, Amy has served in key leadership roles for several Fortune 100 companies. And I'm excited to welcome her to the Target team. Amy is taking the place of Don Liu on our team as he prepares for his retirement.

I want to pause to thank Don for his many years of thoughtful and conscientious service to Target and our stakeholders. He is an outstanding leader who has served as a trusted partner to me, to our Board and our entire leadership team during his tenure here at Target. All of these changes on our team are just the latest evidence of our focus on developing enterprise leaders, ones who go well beyond subject matter expertise to develop strong leadership skills, with a foundation based on a comprehensive understanding of our business and how we fit into the broader landscape.

And as you've seen from our second quarter results, the strength of our entire team was clearly evident in our financial performance, which came in well above our expectations. On the top line, we met our goal of returning to growth, but moved well beyond that baseline expectation. More specifically, our Q2 comparable sales grew 2% at the very top end of our guidance range. And on the bottom line for the quarter, our EPS of \$2.57 was well above the high end of our guidance, representing growth of more than 42% over last year.

Among the drivers of our comp sales, we're pleased that our second quarter growth was driven entirely by traffic, reflecting the combined benefits of the multiple guest-focused initiatives we outlined in our financial community meeting back in March. It's also notable that our store and digital channels both saw growth in Q2. Our digital team has done an outstanding job of enhancing our digital experience, and that's showing through in our business results.

We saw high single-digit growth in our digital comps in Q2 and even faster growth in same-day services, led by Drive Up and Target Circle 360, both of which grew in the low teens. Same-day services now account for more than two-thirds of our digital sales, with the biggest contribution from Drive Up, which generated sales of more than \$2 billion in Q2 and more than \$4 billion so far this year. Our balanced, multi-category merchandising assortment continues to resonate with our guests as trends strengthened across the board in Q2. And were particularly encouraged to see discretionary category trends improve for the fourth consecutive quarter.

In apparel, comp sales grew by more than 3%, marking an improvement of more than 5 percentage points when compared with the first quarter. Our apparel team has done a fantastic job of incorporating great design, newness and value throughout their assortment, most notably in our All In Motion brand, which delivered growth in the low teens. Beauty was another standout as the category continued to gain share, with comp growth of 9% in Q2 on top of double-digit growth a year ago.

On the frequency side of our assortment, both our food & beverage and essentials categories saw traffic growth in the quarter as consumers are responding to our offerings in an environment where they are focused on value. Over the summer, we reduced our prices on about 5,000 frequently purchased items in many markets, and we saw an acceleration in both our unit and dollar sales trends in these businesses. We're also seeing continued momentum in our Target Circle loyalty platform following its relaunch in the first quarter. With over 100 million members, we're always happy to welcome new guests who choose to join, and we added more than 2 million new members in the second quarter.

But our aspirations go well beyond growing our membership base. We redesigned Target Circle with the goal of increasing engagement among existing members, and we've already realized the benefits. For example, during our July Target Circle Week, about two-thirds of our transactions were made by Target Circle members. Beyond the direct benefit of guest engagement with the platform, Target Circle also helps us gain deep consumer insights, allowing us to extend more personal, customized offers through our Roundel advertising business.

Roundel continues to experience rapid growth, based on the joint value it creates for both our guests and our vendors. In the second quarter, Roundel delivered double-digit growth to the benefit of both gross margin and the other revenue line of our P&L. For the full year, Roundel is expected to grow in the high teens on top of more than 20% growth in 2023.

As we continue to survey consumers and monitor the external environment, our view remains largely the same as we've been sharing for some time. Consumers have shown remarkable resilience in the face of multiple challenges over the last several years, and they remain resilient today. Given the significant headwinds they've faced with inflation over the last few years, consumers continue to focus on value as they work hard to manage their household budgets. And while they continue to turn out and shop around holidays and other seasonal moments, many are delaying purchases until the moment of need.

Against that backdrop, our team continues to focus on providing unbeatable value for our guests. And of course, that starts with a focus on low everyday prices, including our recent price reductions on frequently purchased items. But our focus on value only begins with low prices. Whether we're highlighting compelling deals for our Target Circle members, offering an additional 5% savings to our Target Circle cardholders, designing and sourcing high-quality owned brands at compelling prices or delivery, ease and convenience with Drive Up and Target Circle 360, our team is continually working to find more ways to deliver more value for our guests.

As we look ahead, our team is focused on controlling what we can control. We're committed to staying on offense while maintaining an overall cautious outlook, a stance that has worked well for us over the last few quarters. Throughout the company, we're focused on retail fundamentals and strong execution. This includes our commitment to being in stock and reliable even as we maintain a prudent inventory position. It also includes our focus on delivering speed and convenience in every fulfillment channel, while providing efficient and friendly service to our guests in every store, every day.

We're also looking to build on the momentum we've been seeing in discretionary categories where trends have already improved significantly, and we see much more opportunity ahead of us. We're focused on continued expansion of our operating margin rate as we move back towards and potentially beyond the 6% annual rate we were earning before the pandemic. We're committed to continued disciplined capital deployment. Following more than a year of hard work to strengthen our balance sheet, we were pleased to get back to share repurchases in the second quarter, and we expect to have continued capacity within our Middle A ratings in Q3 and beyond.

And of course, we're focused on continued investment in our team, in their training, development, pay and benefits. To support our team, we're making smart investments in AI technology to make their work easier and more productive, enabling them to serve our guests with even greater speed and efficiency. All of these efforts are in support of our ultimate goal: To deepen the already strong relationship we have established with our guests. While it was fantastic to see top line growth in the second quarter, it was even more gratifying that was driven by traffic as more guests choose to make more trips to Target, following unprecedented growth during the pandemic.

Altogether, over the first six months of 2024, our guests have already made nearly 1 billion trips to Target, a number that's grown by more than 20% since 2019. We're grateful for the underlying trust and engagement behind every one of those transactions, and our entire team is focused on delivering continued traffic growth over time.

So now before I turn the call over to Rick, I want to pause and thank our team. Back at our Financial Community Meeting in March, I described how they were united in their commitment to moving from go time to grow time, and they've certainly delivered and more. In an environment where consumers continue to make meaningful trade-offs, -- our Q2 results demonstrate the power that comes from the right combination of newness, seasonal relevance and compelling value.

While that's great to see, the team isn't pausing to celebrate. Rather, they're leaning in as they focus on building additional momentum in the back half of the year and beyond. Our team is the best in retail, they're guest-focused and they love to win together, and they're just getting started.

With that, I'll welcome Rick to his first earnings call.

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**Rick Gomez** - Target Corp - Executive Vice President, Chief Commercial Officer

Thanks, Brian, and good morning, everyone. I'm excited to be joining this call today, and I'm looking forward to meeting many of you over time. Before we unpack our second quarter results, I'd like to spend some time sharing my priorities as I step into this role, many of which should sound very familiar.

First, I want to reinforce the importance of the areas that Christina was focused on: affordability, newness, seasonal relevance and ease. These are mission-critical. Under Christina's leadership over the years, we've built an incredible foundation which we can build upon. I've also worked with the team on three additional principles to govern how we work.

First, we'll focus on simplifying processes end to end, including how our teams work together as well as with our external partners, with the goal of driving efficiencies and streamlining how work gets done. We should also be relentless in our pursuit of creativity, bringing innovative ideas to market that are original, inspiring and unmistakably Target. And finally, we shouldn't be just guest-led, we should be consumer-obsessed. We'll do this by consistently listening to what consumers want and need and then working hard to deliver for them.

Next, I'll turn to our view of the consumer, which, as you heard from Brian, has remained largely unchanged for some time. American families continue to deal with a lot. These pressures are clearly weighing on them, and they're looking for a refuge from the everyday stress that they're feeling. And yet while the economic data remains mixed, we see a consumer that is still willing and able to spend. Yes, they're still being choiceful. Yes, they're budget conscious. And yes, they're hunting for deals and everyday value. But they're also willing to shop when they find that right combination of fashion and newness at the right price. This was on full display in our second quarter results.

As Brian mentioned, the team was committed to returning to growth this year, and they did just that in Q2 with comp growth of 2% driven entirely by traffic. Also note, every one of our core categories saw traffic growth in the quarter. Sales from Target Circle 360 grew in the low teens this quarter, adding to our confidence that we have a long runway ahead of us to drive awareness and adoption of this differentiated service. In support of this goal, we recently rolled out a new monthly subscription option for Target Circle 360, allowing guests to get the best of Target delivered same day for just \$10.99 per month and only \$4.99 per month for students.

Within our assortment in Q2, we saw notable areas of strength in both discretionary and frequency categories. As Brian highlighted, discretionary trends have been improving for a full year now, and combined discretionary comps were down only slightly in Q2. This momentum was most evident in our apparel assortment, which delivered low single-digit comp growth driven by newness in combination with strong everyday value, both in stores and online. Comps were led by our performance category in the low double digits as guests loved our latest designs and unbeatable prices in our All In Motion brand.

Women's apparel saw growth in the low to mid-single digits, with particular strength in our young contemporary owned brand, Wild Fable. And our recent relaunch of our intimates and sleepwear brand, Auden, has seen a strong guest reaction out of the gate, offering high quality and comfortable items at compelling price points, like \$15 bras and \$20 pajama sets. These results demonstrate the broad-based improvements that we're seeing in apparel, a trend we are eager to build on in the coming quarters and years.

While our Home and Hardlines trends remain softer than apparel, we've also seen meaningful trend improvement over the last year. In Home, Q2 comps accelerated by more than 7 percentage points compared with the first quarter and early results in the back-to-school season are right on plan. Within Home, kitchen continues to stand out based in part on our recent launch of Figmint, our high-performance Kitchenware brand. Within Hardlines, while sales in electronics are still under pressure, we've been leaning into other categories with stronger demand, driving a comp trend improvement of around 5 percentage points versus Q1, driven by newness in the category.

Key growth areas include our affordable outdoor offerings in many markets like \$1 pool noodles and \$10 coolers. Recently, we launched more than 1,000 new items in toys, including over 100 new items in our own brand, Gigglescape, which now includes preschool toys, games, puzzles and an expansion into plush. And in case there was any question of the love for our brand with young shoppers, some of the fastest-growing sales in toys are from Target-themed items, including plush bullseye dogs, kid-sized Target checkout lanes, Target branded poly-pocket toys, Target-branded Fisher-Price little people and so much more.

Beauty continues to gain meaningful market share with comp growth in the high single digits in Q2, driven by a balanced combination of new offerings, celebrity brands, and seasonal relevance. This has been a summer of sun care with guests looking for familiar, affordable options like Up and Up Sunscreen, as well as newer trending brands such as Vacation. Minis have also been a major growth driver, with travel on the rise and consumers looking for a little bit of affordable indulgence for at home too.

In Food, comp sales growth in the low single digits was led by seasonal moments, with hundreds of new items across snacking, grilling and entertaining. With exclusive to Target items like Buble's Melted Ice Pop Flavor, which quickly grew to be the highest selling item in its category, we help guests celebrate summer with fun new flavors and items. In addition to seasonal moments, we've also pushed ourselves to rethink assortment strategies that have been tried and true for years. For example, we transitioned our candy aisles, leading into some of the most popular trends like better-for-you options, including lower sugar treats and wellness candies. While this category was already growing, these changes raised the bar, accelerating comp growth into the double digits.

In Essentials, which also grew in the low single digits overall, Sales growth was largely driven by strength in our Health category, where protein drinks, powders and meal supplements are gaining momentum. Additionally, Baby Care and essentials continue to do well. Across categories, our own brands grew faster than the total enterprise, showcasing the relevance, quality and value we provide to consumers. In fact, because of our industry-leading design and sourcing capabilities, we are better positioned to remove unnecessary steps in the process, which allows us to reduce costs and increase speed to market.

Throughout the second quarter, Target Circle members took advantage of enticing promotions, particularly during our latest Target Circle Week. In fact, this year's Target Circle Weeks have generated the highest digital traffic of the year so far. As Brian mentioned, we added more than 2 million new Target Circle members in the second quarter while also adding hundreds of thousands of Target Circle cardholders and Target Circle 360 members. Because of the invaluable insights we gained through Target Circle, we were able to offer 4 times more personalized offers as compared to a year ago. And of course, those same insights fuel our Roundel media network, which, as Brian mentioned, continues to benefit our business in multiple ways.

While it's hard to believe that summer is already coming to an end, our focus is quickly turning to fall. This, of course, begins with a continuation of our back-to-school and college seasons, which reached their peak in the front half of Q3. More than 70% of our guests shop us during this time frame, and we have plenty in store for them to start the school year off with success and style. Knowing affordability is top of mind for consumers, in many markets this year, we're offering 20 of the most popular school supply items that together are priced under \$20, including items like Mondo Llama crayons for just \$0.25, notebooks for \$0.50 and \$5 backpacks.

For our college-bound guests, we're offering a 20% discount to get their dorm room stocked, styled and ready for studying. And as we do every year, we're acknowledging the true classrooms heroes, our teachers, with a special appreciation event offering an additional 20% of must-have supplies. As the fall season continues, we'll be introducing more and more newness across our assortment to celebrate all things autumn.

In our performance category, we're offering new assortments from All In Motion, including our first-ever women's legging destination with new fabrications and a range of colors, sizes and silhouettes to make all bodies look and feel their best. In our women's categories, we're leaning into our fall fashion assortment, which includes wardrobe options anchored in head-to-toe on-trend neutrals and showcasing the disruptive value of core items for just \$15. And new this year, we are showing up for the game day in a big way, with mix and match apparel items in your favorite college team colors to show some school spirit in style.

Beyond fall fashion, we know consumers are eager for their apple and pumpkin spice favorites, so we're excited to bring back these fall flavors while introducing some new and trending ones as well. Our fall food assortment will offer more than 150 new owned brand items and more than

500 new national brand items, ranging from Pumpkin Donut Holes and Jack-o-Lantern sandwich cookies, to Pecan Pie ice cream and Good & Gather turkey stuffing flavored potato chips. From sweet to savory, guests will find all their favorites and be inspired by what will surely become some new favorites too.

And while Halloween may seem far away, our consumer research and early season sales suggest there's a lot of excitement around this year's celebrations. Last year, social media was ablaze with videos of our 8-foot tall Halloween pumpkin ghoul, Lewis. So we had to bring him back this season along with several new friends, all with their own sassy personalities and catch phrases. We're bringing that own brand love to our costume assortment to. Of course, we're standing tall for all the biggest characters of the season, but we're also seeing an outsized response to our Target branded costumes. And with 75% of the Halloween assortment new this year, we are confident guest will see Target as the Halloween destination for the season.

As it turns out, witches come out for more than Halloween, one of the most anticipated films of the year, Universal Pictures' Wicked hits theaters this fall and our assortment will leave guests spellbound with a collection of licensed products that range from toys to apparel to housewares. We have big plans in store, including exclusive items to Target and we'll have more exciting details to share very soon.

And of course, we don't have to wait for a changing of the season to change up our assortment. In Beauty, after years of meaningful investments in cosmetics and skin care offerings, we're investing in all things hair care. New from L'Oreal is the biggest innovation in at-home hair coloring in years, Colorsonic. This launch is off to a great start, and we see big things ahead for this brand. And more recently, on top of our exciting launch of Jennifer Aniston's LolaVie hair care line, we launched a new partnership with celebrity, Blake Lively, for her exclusive to Target line, Blake Brown Haircare, which quickly became our biggest hair care launch on record. On launch day alone, Blake Brown had the five best-selling hair care items at Target.

Before I turn the call over to Michael, I want to express my gratitude to the entire Target team. The past several years have been anything but routine, and this team has handled every change and turn with grace and a commitment to serving the communities in which we operate. Thank you, Team Target, for all that you do for our guests and for each other.

With that, I'll turn the call over to Michael.

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**Michael Fiddelke** - Target Corp - Executive Vice President, Chief Financial Officer, Chief Operating Officer

Thanks, Rick. I'd like to join Brian in welcoming you to your first earnings call. I'm excited about all of the long-term growth opportunities we have in front of us as we work together to deliver more for our guests, for our team and for our shareholders.

As Brian mentioned, I'm temporarily wearing two hats right now as I continue in the CFO role while preparing to fully move into the COO role. And while I'm looking forward to the day when I'm only wearing the COO hat, I'm privileged to be surrounded by exceptionally talented leaders and teams that are operating with a guest-first long-term focus that's fueling our results. Every day, I see their commitment to caring, growing and winning together. Whether I'm walking a store, a distribution center or the halls in our headquarters, there is no doubt in my mind that our team members are the number one reason that Target is such a special place to work.

As we've been highlighting for some time, the operations team is focused on reinforcing retail fundamentals following an extended period of unprecedented volatility that began more than four years ago. While this effort encompasses many processes and metrics, nothing is more important than staying in stock and being reliable for our guests. And while our in-stock measures have been improving rapidly for some time now, we're going to continue our work to improve them even more.

In the second quarter, total out of stocks were more than 500 basis points lower than a year ago. Also important, out of stocks on our top items in Q2, the ones with the highest unit velocity, were more than 50% lower than total out of stocks and also better than a year ago. Notably, these out-of-stock measures would have been even more favorable if our perishable food distribution facility in Denton, Texas had not sustained major damage from a severe storm in late May, something I'll return to later in my remarks.

It's also notable that our total inventory investment at the end of Q2 was slightly lower than a year ago, meaning that the out-of-stock improvements we've been seeing are the result of operational improvements, not from simply flooding our network with more inventory. Of course, we're always focused on maintaining the right amount of inventory to deliver on our reliability goals, and we're already growing our inventory in categories where demand is strong. But overall, our business has been able to sustain stronger inventory turns than we've seen historically, something you'd expect to happen given the gains in sales per store we've seen over the last five years.

Another area of focus for our team is the store shopping experience, most notably in the front end at checkout. With the recent changes we've made to streamline self-checkout, while ensuring we maintain adequate staffing in our full service lanes, we're seeing notably faster checkout times in our self-service lanes. In addition, with more people using our full-service lanes, our team has been engaging with nearly 15% more guests at checkout compared with last year. And with all of these changes, we've seen a continued substantial improvement in our Net Promoter Scores regarding the purchase experience, with scores related to wait times and interactions at checkout the strongest we've seen in six years.

We're also making investments in technology to make it easier for our team members to serve our guests. Earlier this year, we integrated GenAI into the handheld devices in our stores, providing our team with rapid access to best practice documentation and the ability to quickly receive straightforward responses to common questions, like how do I sign a guest up for a Target Circle card, and how do I restart the cash register in the event of a power outage. Since the full chain rollout of this new tool, our team members have leveraged the technology more than 50,000 times, giving answers in a highly efficient average chat time of less than one minute.

We'll continue to refine this tool over time based on feedback from our team, but many are already telling us that it's enhanced their everyday work experience, making it easier and faster for them to help our guests. In addition, leaders in our stores are telling us they expect this new tool will be particularly helpful as we bring on new permanent and seasonal team members in advance of this year's holiday season, helping them to become more productive, more quickly than in the past.

Of course, while well documented, efficient and repeatable processes are critical to maintaining quality in a large operation, it's just as important to help our team to stay nimble and able to react to unforeseen events. And our team had to deal with several weather-related challenges in the second quarter. As I mentioned earlier, our Denton, Texas perishable food distribution center sustained significant physical damage from a storm in late May, resulting in a prolonged site closure and significant product loss at that location.

Following the storm, the team reacted quickly to minimize the impact, temporarily realigning perishable food replenishment for 220 locations with other distribution nodes, while our construction and distribution teams rushed to get the facility repaired and operational before the end of the quarter. Later in the quarter, in early July, Hurricane Beryl hit landfall in Southern Texas, and our team responded quickly to help their neighbors in affected communities. When power was lost in multiple locations, our team successfully kept stores open using generators providing food, supplies and a safe place for community members to take shelter and charge their electronic devices.

Our team helped to organize and deliver donations of critical supplies to their neighbors, while helping to clear debris from nearby roads and homes. And as always, our team members took care of each other from cooking meals for displaced colleagues to making sure everyone had access to emergency supplies and shelter. To support these heroic efforts in the field, we maintain a robust infrastructure, supported by a core team at our headquarters that's ready to provide communications and support when disasters happen. As part of these preparations, we reserve and preposition thousands of pallets of critical supplies throughout our distribution network, which can be quickly deployed to affected areas when events occur.

We also maintain a command center at our headquarters that's equipped to monitor weather and other conditions in the areas where we operate, helping our field teams to prepare and react quickly to minimize the impact when adverse events affect our communities, colleagues and our business. And of course, we're proud to continue offering financial support in affected communities, having already made proactive donations of \$2.5 million so far this year in support of our domestic and global disaster relief partners.

Following Hurricane Beryl, our donations helped the American Red Cross stand up more than 10 evacuation centers in Houston. We also supported Team Rubicon as they worked to clear fallen trees, helped homeowners navigate FEMA applications for disaster assistance, aided the footprint



project in providing solar generators to power homes and medical machines, and provided food, medicine and other critical supplies to the hardest hit neighborhoods.

So much of our Target Forward sustainability strategy is dedicated to working across the business, to address community needs and drive meaningful and positive impact. Through Target's philanthropy and volunteerism, and by integrating business assets to meet the needs of our communities, we aim to be present in ways that help all families thrive, knowing the guests and communities we serve are critical to the success of our business.

So I want to pause and thank our entire team for their tireless efforts, both every day and especially during times of need. You serve as the face of the company in all of the communities where we live and work, and you are the biggest reason consumers love our brand. I'm proud to work with you and grateful for everything you do to support our business, our communities and your fellow team members.

So now I want to pivot and provide a quick update on our sortation center strategy, which continues to benefit our business in multiple ways. A critical aspect of this strategy is faster delivery speeds as local orders processed through a sortation center arrive more than a day faster than our network average. But notably, that increase in speed doesn't require more dollars, as our unit delivery costs from a sort center are about 20% lower than our network average. On top of that direct benefit, opening a sortation center in a market frees up processing space in the stores it serves, while delivering labor savings in those locations as well.

With all of these benefits, you can see why we're excited to continue expanding the reach of this capability. And just this month, we're opening our 11th sort center in the Detroit market, where it's expected to serve more than 3 million consumers. By 2028, this facility is expected to process up to 60,000 packages daily while operating in a smaller-than-average footprint. And beyond growth in the number of these facilities, our existing sort centers continue to ramp up their capacity, and we're finding new ways to integrate them into our broader network.

For example, our recently opened flow center in Chicago will be feeding the Detroit sortation center, increasing the number of packages eligible for next-day delivery in that market. Altogether this year, our sortation centers have processed 19% more packages than a year ago.

So now I want to turn to our second quarter financial results. As Brian highlighted earlier, the 2% increase in our Q2 comp sales was driven entirely by traffic. This traffic increase was partially offset by a decline in average ticket, which included a decrease in our average selling price when compared with a year ago. As Brian mentioned, our guests continue to shop around seasonal moments, leading to strength around the Memorial Day holiday as well as the Fourth of July and our most recent Target Circle week later in the quarter. Within the quarter, comp sales were strongest in June and July, and trends were very similar between those two months on a reported basis. Most importantly, traffic grew in all three months of the quarter.

Beyond our comp sales, second quarter total revenue growth of 2.7% reflected the benefit from sales in nonmature stores and double-digit growth in other revenue, driven primarily by strong growth in our Roundel ad business. Our second quarter gross margin rate of 28.9% was about 190 basis points higher than a year ago. About 90 basis points of this improvement was driven by our merchandising strategies, which included the ongoing benefit of our efficiency work. We also saw about 40 basis points of benefit from category sales mix, which was largely offset by cost pressures from digital fulfillment and supply chain.

Finally, our gross margin rate reflected about 90 basis points of benefit from lower inventory shrink, compared with a 20 basis point benefit in the first quarter. While our guidance assumed that the year-over-year benefit from shrink would increase this quarter, we've seen better-than-expected results in our most recent store inventory counts, resulting in a bigger-than-expected financial benefit in Q2. Based on these updated accounts, we're now expecting our Q3 gross margin rate will also benefit from lower shrink costs, but expect the magnitude of that benefit will be less than half of what we just experienced in the second quarter.

And for Q4, given the financial benefit we were already seeing a year ago, we're expecting shrink costs will be approximately flat to last year. While it's encouraging to see this progress, we'll continue our work to move shrink rates down to more sustainable levels in the years ahead, given the steep increase in shrink that our business has absorbed over the last five years.

Our second quarter SG&A expense rate of 21.2% was about 30 basis points higher than a year ago. This increase reflected cost increases in multiple parts of our business, along with continued investments in our team, which were partially offset by lower remodel expenses, savings from our efficiency work and continued disciplined cost management throughout the enterprise. Overall, our Q2 operating margin rate of 6.4% was about 160 basis points higher than last year as we continue to build back our profitability from the significant headwinds we've encountered over the last couple of years.

Regarding our inventory, we continue to feel good about our position. As I mentioned earlier, Q2 ending inventory on the balance sheet was slightly lower than a year ago. However, given all of the volatility we've experienced since the pandemic began, 1-year comparisons can be hard to interpret. As such, we still find it useful to compare relative growth rates back to 2019. And if you perform that comparison for the second quarter, you'll see that both our sales and ending inventory have grown about 38% over those five years, reinforcing our view that we're positioned appropriately as we enter the back half of the year.

Now I'd like to turn to capital deployment and briefly reiterate our long-standing priorities. First, we look to fully invest in our business and projects that meet our strategic and financial criteria. Next, we look to support the dividend and build on our more than 50-year record of increasing the annual dividend. And finally, we look to return any excess cash that's available after these first two uses by engaging in share repurchases over time within the limits of our middle-A credit ratings.

Regarding the first priority, we've allocated \$1.3 billion to capital expenditures through the first half of the year and continue to expect full year CapEx in the \$3 billion to \$4 billion range. Regarding the second priority, we returned \$509 million to shareholders in the form of dividends in Q2, representing growth of about \$10 million over last year. And finally, we returned to share repurchases in the second quarter, allocating \$155 million to retire 1.1 million shares of our stock.

Given the work of our team to strengthen our balance sheet over the last 18 months and the simultaneous improvements we've seen in our profitability and cash flow, we were happy to get back to repurchases this quarter. We expect to have continued repurchase capacity in the back half of 2024 and in the years ahead.

So now I want to end my commentary on the quarter by covering our after-tax return on invested capital, which is an important measure of the quality of both our financial results and our capital investments. Through the 12 months ending in the second quarter, our after-tax ROIC of 16.6% was nearly 3 percentage points higher than a year ago. While this is already a very strong after-tax return, our long-term financial plans envision continued growth of this metric into the high teens over time.

Now I'd like to turn to our expectations for the third quarter and the full year. And while our performance has exceeded our expectations so far this year and our view of the consumer remains largely the same, the range of possibilities and the macroeconomic backdrop in consumer data and in our business remains unusually high. Against that backdrop, our experience over the last several years has shown us that a prudent outlook, while maintaining the team's agility, is the best way to position our business. As such, we've taken a measured approach to our forward-looking guidance, and our team remains ready to respond if the pace of our business turns out to be stronger.

With these considerations as context, we're planning for third quarter comparable sales growth in the 0% to 2% range, and GAAP and adjusted EPS of \$2.10 to \$2.40. And while our full year comp guidance range remains the same at 0% to 2% growth and the breadth of possibilities remains quite wide, our baseline plan for the fall season would put us in the lower half of that range for the full year. However, in light of the strong financial performance our business has already delivered in the first half of the year, we've raised our full year GAAP and adjusted EPS range to \$9 to \$9.70 compared with our prior range of \$8.60 to \$9.60.

At our Financial Community Meeting earlier this year, we provided insight into our financial aspirations over the next 10 years. At their core, those aspirations are based on two basic assumptions: healthy growth on the top line and reaching the appropriate level of profitability on the bottom line. In the second quarter, in an environment where consumers are focused on value and making tough trade-offs in their spending decisions, our team delivered newness, value and reliability to our guests, resulting in top line growth beyond our baseline expectations and even faster growth in guest traffic.

And importantly, even in a challenging environment, we also expanded our Q2 operating margin rate. We are really proud of these results, which reflect the hard work and dedication of our outstanding team. At the same time, this quarter was only the first step on a much longer journey and we have a lot more work ahead of us. More specifically, with 2019 as a baseline, the second quarter was the first time in a while in which our EPS grew faster than the top line, with total revenue growth of 38% over that 5-year period and EPS growth of more than 41%. Our guidance for the remainder of the year implies further expansion of both of those metrics. And based on our growth initiatives, ongoing efficiency work and continued opportunity to reduce the impact of inventory shrink, we expect to see additional progress in the years ahead.

We have a clear vision of how we're going to get there and the right team in place to make it happen. With that, I'll turn the call back over to Brian.

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**Brian Cornell** - Target Corp - Chair and Chief Executive Officer

Thanks, Michael. Before we turn to your questions, I want to spend a minute on a concept we've touched on before, which is the way we uniquely leverage the power of and in our business. The reason Target is so unique, and why we've developed such a special bond with consumers is because we offer something different than everyone else in the marketplace. We offer great prices, convenience, compelling promotions and a great shopping experience.

Our nearly 2,000 stores are accessible to the vast majority of the US population, and we have a comprehensive suite of fast and convenient digital fulfillment options. For destination in discretionary categories like apparel, Home and Hardlines; in frequency categories, like Essentials and food & beverage and in Beauty, which perfectly straddles both, we offer a broad range of items, serve as a convenient one-stop shop and we're well known for curating our merchandise assortment. We are a style leader. We're known for celebrating seasonal moments and we offer reliability on everyday wants and needs.

When we're at our best, we achieve a proper balance between all of those aspects or go-to-market strategy, and the second quarter was a textbook example of Target being Target. I'm incredibly proud of our team for delivering better-than-expected results in an environment where consumers are facing multiple challenges. Knowing there's more work to be done. Our team is on their front foot and ready to deliver more for our guests in the third quarter and beyond. Our team's positive energy is contagious, and I look forward to working with them as they continue to move Target forward in the quarters and years ahead.

So with that, we'll move to Q&A. Rick, Michael and I will be happy to take your questions.

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## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions) Kate McShane, Goldman Sachs.

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**Kate McShane** - Goldman Sachs & Company, Inc. - Analyst

You mentioned that you haven't seen a notable change in the consumer versus what you've seen year-to-date. Can you help us understand or reconcile your ability to get to the high end of guidance range for quarter 2, maintain the guidance range for Q3, but also flagged you are likely to get to the lower end for the same-store sales guidance range for the year?

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**Michael Fiddelke** - Target Corp - Executive Vice President, Chief Financial Officer, Chief Operating Officer

Thanks for the question, Kate. I think the headline is, at the start of your question, we see a consumer that's largely consistent with how we would have described the consumer over the last couple of quarters. Consumer that's been resilient overall in their spending and flat in spite of significant

inflation over the last couple of years. A consumer that's choiceful, and so our combination of getting newness and value right in the second quarter led to the performance that was at the top end of our expectations.

As we look at the balance of the year, we've got more of the year in front of us than is behind us, and we think it's prudent to take a measured view against the kind of consumer behaviors we'll be watching over the balance of the year. But importantly, that guidance is still centered on growth. We expect to continue to grow in Q3. We expect to have a growth story for the year. And you can see us playing offense appropriately against that goal, but being measured in our outlook. We think that's the right way to position the business.

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**Brian Cornell** - *Target Corp - Chair and Chief Executive Officer*

Kate, just to build on Michael's comments. I think in this environment, where there is so much consumer uncertainty, we're taking the appropriate approach to guidance in the third quarter. But as you heard from Rick and from Michael, we're continuing to play to win, and we feel very good about how we're prepared for the big seasonal moments. We're in back-to-school right now and back to college. We're excited about Halloween. And Rick and his team are planning for some unique moments during the holiday season.

So I don't want anyone to be confused with what we think is the appropriate outlook for the third quarter, but the fact that we're going to continue to play offense. We're going to look to drive traffic into our stores and visit to our site, and make sure we deliver great value along with newness for our guests throughout the season.

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**Operator**

Rupesh Parikh, Oppenheimer.

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**Rupesh Parikh** - *Oppenheimer & Co. Inc. - Analyst*

Also congrats on a nice quarter. So I just wanted to go back to the operating margin performance during the quarter. We still had very strong delivery during the quarter. How do you feel about the sustainability of the improvement? And then over time, getting back to that 6% plus margins on an annual basis?

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**Michael Fiddelke** - *Target Corp - Executive Vice President, Chief Financial Officer, Chief Operating Officer*

Yes. Thanks for the question, Rupesh. As we laid out at the start of the year, this year was going to be about progress to that better margin performance over time. And two quarters in, I just can't thank the team enough for their work to put us solidly on the path of the improvement that we laid out for the year. If you unpacked the quarter, I hit on some of this in my remarks, but it always starts with the top line. So to grow the top line on a 2% comp. To see a category like apparel -- so we like the margins in apparel, to see that category return to growth helped us from a mix perspective.

Great work by the team to continue to find efficiency within the business. And we expected a more promotional environment this year. We've certainly seen that so far. But you can see the strength on the margin line due to the team's really hard work to continue to squeeze efficiencies out of the business in ways big and small. And we're pleased with the progress we're making on shrink. Now there's some noise quarter-to-quarter about how that will come through. So tried to unpack some of those details in my prepared remarks. But the net punch line there is we're ahead of where we expected to be in terms of progress on shrink too. And so all that's adding up to an earnings result, we're certainly pleased with. And our work going forward will be continue to continue that momentum in Q3 and Q4.

**Brian Cornell** - *Target Corp - Chair and Chief Executive Officer*

Rupesh, I'd just amplify a couple of the comments you've heard us make over the last few quarters and really recognize the focus the teams placed on retail fundamentals. Michael talked about the progress in reliability, improving our in-stocks. Rick talked about the improvement in value and the commitments we've made to making sure we provide value to our guests no matter where they're shopping and how they're shopping. And I think that focus on controlling the things we can control is really helping us improve our operating margin performance.

But the team has been very focused on retail fundamentals, execution each and every day, both from a physical standpoint and a digital standpoint. And I think you're seeing the benefits of that pay off.

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**Operator**

Chris Horvers, JPMorgan.

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**Chris Horvers** - *J.P. Morgan Securities LLC - Analyst*

My first question is, can you talk more specifically about what drove the strength in the merchandise margin strategy in the second quarter? And what are you embedding in the back half in terms of sustainability?

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**Michael Fiddelke** - *Target Corp - Executive Vice President, Chief Financial Officer, Chief Operating Officer*

Yes. Thanks for the question, Chris. There's a lot that goes into that margin line on any quarter. And so the headlines are some we've touched on a little bit already. We've definitely seen a more promotional environment. But against that backdrop, the teams have worked hard to find efficiencies within the business. And that can show up in ways big and small. To give a tangible example, and one of the things that we've continued to see progress with is -- the most expensive thing we do in fulfilling product is shipping a brown box, and we've seen significant improvement in the cost per unit of that activity, as teams have worked to better align inventory with where we see demand. So we have to split shipments less frequently.

And the core productivity within those processes, big improvements in our stores team, delivering that product more efficiently as we pick and pack in the stores, and so that work adds up. And the teams have been at it for multiple quarters now, and we're seeing it pay off.

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**Chris Horvers** - *J.P. Morgan Securities LLC - Analyst*

Understood. And then on the top line, I was just curious how you forecast the business. Obviously, the consumer has been a lot more volatile, a lot more event-driven. There seems like there was some pause in the back, half of July. As you plan the business, do you look at seasonal revenues building off the second quarter? Are you looking at stacks? Are you looking at trends versus 2019? Just some insight there in terms of how you forecast the business.

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**Brian Cornell** - *Target Corp - Chair and Chief Executive Officer*

Chris, I think you've covered many of the things we look at on an ongoing basis. And I think we factored all those different variables into our outlook for the period and the quarter.

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**Operator**

Simeon Gutman, Morgan Stanley.

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**Simeon Gutman** - Morgan Stanley Co. LLC - Analyst

I wanted to ask on a near-term question first. It sounds like comps June and July were relatively steady. And I don't know if you talked about product back-to-school, curious about how the consumer is behaving. And then connected to it, any expectation when the discretionary comps may inflect to positive?

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**Brian Cornell** - Target Corp - Chair and Chief Executive Officer

Simeon, as we sit here today, obviously, we're in the heart of back-to-school season, kind of the early chapters of back to college. And as Rick talked about, excited about the upcoming Halloween season. I think as we sit here today, we feel well prepared for those big seasonal moments, and we'll continue to make sure we lean in with a great physical and digital experience.

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**Simeon Gutman** - Morgan Stanley Co. LLC - Analyst

Maybe one follow-up. Can I ask about price investments, the 5,000 items that have been lowered if, one, I assume you're pleased with some of the elasticity. Does it make you think about price positioning broadly? Are there opportunities to enhance the price position in other places?

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**Brian Cornell** - Target Corp - Chair and Chief Executive Officer

I think we sit here today, we feel really good about the way the consumers reacted to the price investments we've made on those 5,000 frequently purchased items, but it really goes beyond those investments. If you're a Target Circle member, you're getting personalized offers every time you shop. If you're using a Target Circle card, you have the opportunity for that 5% discount. If you're taking advantage of the amazing value we provide through our own brands, that's just one more way to find value when you're shopping with Target.

So it's really a bundle of all those things that we do each and every day, to strengthen the relationship we have with the guests and provide them with the value they're looking for in this economic environment.

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**Operator**

Robbie Ohmes, Bank of America.

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**Robbie Ohmes** - BofA Global Research (US) - Analyst

Outstanding quarter. I was hoping, maybe from Brian or others, you could talk about a couple of things, Target Circle penetration. It hasn't been going up is that expected to change? And also same-day delivery is still -- and I guess, Target Circle 360, as you call it, is still not growing as fast as Drive Up. Is that expected to change? And with changing these things potentially be a sales driver? And then is there any margin implication from that on the offset?

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**Brian Cornell** - Target Corp - Chair and Chief Executive Officer

Yes. Robby, you've got three or four questions there. I'm going to let Michael start. I'll pick it up from there.

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**Michael Fiddelke** - Target Corp - Executive Vice President, Chief Financial Officer, Chief Operating Officer

Yes. Importantly, Robby, I'll kind of take your second point first. We're really pleased with our Circle 360 same-day delivery business, both it and drive-up grew in the low teens. And so we've seen some acceleration in that business on the heels of our relaunch of Circle, and so we're encouraged by that. And importantly, both of those services. We've talked about this before, but I think it warrants a reemphasis. The thing we see when people engage with Drive Up and with Circle 360 same-day delivery is they spend meaningfully more at Target in total, and they're in-store shopping actually increases after they become users of those services.

And so we continue to watch that relationship closely and growth of those services means growth in our share of wallet with the consumers that use those services. Speaking to circle more specifically, and I believe your question was focused on Circle card penetration. We see that opportunity over time with the relaunch of Circle to bring some investment back to growing our card business. One of the things that, that relaunch of Circle provides is it brings the core base Circle program, where guests can find incredible value through the personalized offers that they receive every day; with the Circle card program, where you can save an extra 5% if you're a Circle card member; with Circle 360 program, if you want the best of Target brought to your doorstep. And the integration of those programs, we think, provides a good jumping point off over time to continue to reinvigorate the Circle card business, but that's going to be a journey of quarters and years.

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**Brian Cornell** - Target Corp - Chair and Chief Executive Officer

Probably just to clarify a couple of points. From a base Circle program standpoint, we did note that while we start with a base of over 100 million members, during the July Circle Week, we saw 2 million new members join the program. You talked about Drive Up and Target Circle 360. And Drive Up has been a very sticky service for us and just continues to grow. And during the second quarter, we saw a Drive Up grow over 14%, and a nice acceleration in Target Circle 360 same-day delivery of almost 14%.

So we see tremendous opportunity to continue to expand our Target Circle 360 program. But I'd really highlight Drive Up has been a stellar performance for us for many years now and just continues to grow. It was a \$2 billion business for us in the second quarter. And I think, Michael, year-to-date is almost \$4 billion. So it's been a really important service that we know our guests appreciate. But to Michael's point, we know they're a Drive Up user, they're going to spend time in a Target store, and we really like that combination.

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**Operator**

Ed Kelly, Wells Fargo.

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**Ed Kelly** - Wells Fargo Securities, LLC - Analyst

I was hoping that you could provide a little bit more detail on discretionary comps, still negative here. What do you think is happening with market share at this point? And then maybe can you talk a bit about when you think that category is in total may inflect positively?

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**Brian Cornell** - Target Corp - Chair and Chief Executive Officer

I'm going to let Rick talk about some of the trends we're seeing in discretionary categories. He talked about the strength in apparel and some of those subsets within apparel, but we're also seeing green shoots in other areas. And we certainly think that over time in categories like home, led by Kitchen, as these purchase cycles become ones that need to be replaced, you're going to see some strength in those categories. But Rick, why don't you walk through some of the trends you're seeing in discretionary categories.

**Rick Gomez** - Target Corp - Executive Vice President, Chief Commercial Officer

Sure. I'd be happy to give a little color commentary to the trends and what's driving those trends. And what we're seeing in discretionary is when we offer on-trend stylish product at a great price, the consumer responds. And we're seeing that in apparel. Apparel delivered a 3 comp. So real bright spots was All in Motion performance brand, where the team did a fantastic job on fabrication, colors, fit. \$25 leggings was a fan favorite and really demonstrated the power of fashion combined with affordability.

Beyond that, Beauty is also a standout, where we see news really resonating with the guests. I mentioned in the comments, but it's really exciting to see the success of Blake Lively's new hair care line, Blake Brown. We just launched it a few weeks ago, and it is already the most successful hair care launch that we have ever had at Target. And I think this is another great example of the consumer is willing to buy when they find that right combination of on-trend, stylish product at an affordable price.

And even in other businesses, I use Home as an example, consumers want to freshen up their home. They want to freshen up their look, but they need to do it on the budget. So where we see growth is things like candles, decorative accessories, throw pillows. We're seeing growth there because we're offering an inexpensive way to freshen up the look of your home. So again, it goes back to delivering stylish on-trend product at a great price..

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**Brian Cornell** - Target Corp - Chair and Chief Executive Officer

And I'll give you one of my favorite examples from earlier this year, and it's a collaboration we had with our partners at Authentic Brands, leveraging the Prince brand. And while that brand has been known for tenants throughout the years, we brought the Prince category and the Prince brand into pickleball, with great new apparel, accessories and rackets. And we've created a destination and target for all things pickleball. We know families across the country are enjoying that sport. It fits very nicely with our all-family position.

And it's just one more example of when Target is Target. When we bring great design that's on trend at a great value, we see the guests reacting really positively. So you'll see Rick and his team continue to make sure that we're bringing that combination of design and on trend, great value, great newness into those categories to continue to spark greater demand.

Operator, we have time for one final question today.

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**Operator**

Corey Tarlowe, Jefferies.

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**Corey Tarlowe** - Jefferies LLC - Analyst

I was wondering if you talk a little bit about your expectations for longer-term mix of food & beverage over time. That's a category where you've continued to grow over the last several years, specifically since the pandemic, especially as you've widened the assortment and the number of items that you've carried in that category. So I would be really curious to hear your thoughts around the long-term trajectory for that business over time.

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**Brian Cornell** - Target Corp - Chair and Chief Executive Officer

Corey, I'm happy to start, and I'm going to turn it over to Rick who, obviously, was leading our food & beverage business. We think we have significant opportunity for growth in that space, led by the unique combination, again, of great national brand partnerships and some really strong owned brands that have connected with the consumer. So we think we're still in the early days of building out our Food business. But Rick, you've got so much experience in the space, why don't you share some of your thoughts?



**Rick Gomez** - Target Corp - Executive Vice President, Chief Commercial Officer

I'd be happy to offer a little color commentary on the food & beverage business. And as Brian said, we believe there is continued runway for the business to deliver growth, driven by a few things. The first is continued emphasis on affordability. As we talked about, the 5,000 price reductions across everyday items was incredibly well received. We'll continue to lean into value on our food & beverage business, not just through everyday pricing, but also through personalized promotions on Circle, as well as with our own brand portfolio, which offers incredible value.

The second thing that will continue to lean in to drive growth for food & beverage will be newness. Just going into the fall season, right now, we have a ton of new products coming, over 150 new owned brand products, over 500 new national brand products. Leveraging those flavors that everybody loves for the fall. I'm talking about Pumpkin Spice, Apple, Pecan Pie, that will continue to fuel growth.

And then the last opportunity to continue to drive growth in our food & beverage business is around ease and convenience. Consumers have a lot on their plate, and they're looking for simple solutions, and we're very excited about the continued growth that we're seeing on both Drive Up as well as same-day delivery, which is achieving double-digit growth in Q2, and we continue to see runway on that going forward.

**Brian Cornell** - Target Corp - Chair and Chief Executive Officer

Operator, that concludes our second quarter conference call. I appreciate everyone joining us, and we look forward to talking to you again soon.

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