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# EDITED TRANSCRIPT

TGT.N - Q4 2022 Target Corp Earnings Call

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## OVERVIEW:

Co. reported 4Q22 results. Expects 2023 comparable sales to be in a range of a low-single digit decline to a low-single digit increase and 2023 GAAP and adjusted EPS to be \$7.75-8.75. Expects 1Q23 comparable sales to be in a range of a low-single digit decline to a low-single digit increase and 1Q23 GAAP and adjusted EPS to be \$1.50-1.90.

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**John Hulbert** *Target Corporation - VP of IR*

**John J. Mulligan** *Target Corporation - Executive VP & COO*

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## PRESENTATION

**John Hulbert** - *Target Corporation - VP of IR*

Well, good morning, everyone, and welcome to our 2023 Financial Community Meeting. I'd like to start by welcoming the investors and others who are attending this meeting remotely. And of course, we're happy that so many of you have joined us here in person today.

Before I turn it over to Brian to start the meeting, I have a couple of important disclosures. First, any forward-looking statements that we make this morning are subject to risks and uncertainties, the most important of which are described in our SEC filings. And second, in today's remarks, we refer to non-GAAP financial measures, including adjusted earnings per share. Reconciliations of all non-GAAP measures to the most directly comparable GAAP measure are included in our financial press releases, financial presentations and SEC filings, which are posted on our Investor Relations website.

With that, I'll turn it over to Brian to begin the meeting.

(presentation)

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**Brian C. Cornell** - *Target Corporation - Chairman of the Board & CEO*

Well, good morning, and thank you for joining us. Looking forward to spending this time with you. We're eager to share our plans, including how we'll continue to grow, how we'll continue to rebuild profitability on that growth and how we'll strengthen our business in conditions that have changed a lot since we gathered here at the Times Center last year.

At that time, we just passed a crucial milestone. We had just become a \$106 billion company. For the full year 2022, which we're reporting today, we placed another \$3.1 billion of revenue growth on top of that growth. We grew traffic by 2.1%. We gained unit share across our core merchandising categories, which means that consumers who were constrained by inflation and have to be very selective about where they shop and what they buy, continue shopping and buying at Target. And despite difficulties throughout the year, we closed the books on 2022 with our 23rd straight quarter of comp sales growth. However, the path between last year's Times Center meeting and this one was anything but predictable.

When we last gathered here, New York was still under a mask mandate. And though -- although consumers had started moving towards postpandemic behaviors, with families returning to travel and restaurants and shifting some dollars at a retail, we are just beginning to see how volatile and uncertain 2022 would become as spiraling inflation forced families to put discretionary purchases on hold and focus most of their spending on necessities. And there was a rapid escalation to the most expensive operating environment we've seen in decades, all of which was made worse by the spike in fuel prices caused by Russia's war on Ukraine. Those variables and many others continue to have a profound effect on the retail landscape.

So this morning, we want to take stock of that situation. We want to speak clearly of how Target is planning to stay on our growth path for the years ahead. We're keeping this morning's agenda very focused on our strategy, operations, growth investments and financial expectations. We see this as a time to combine steady leadership with our long-term strategy and a continued focus on agility and strong focus on retail fundamentals. Our goals this morning are to show you how we're navigating near-term challenges. How the durability of our business model lies in its flexibility. We'll share what we're prioritizing to stay in step with our guests, and how we'll flex across our multi-category portfolio, which means, in the near term, leaning into growth in nondiscretionary categories.

We'll also reinforce how the trust and loyalty we've built with our guests shows in our traffic and share gains. Given value is absolutely top of mind right now, being able to deliver affordable joy, differentiates us in the marketplace. And that's a clear advantage in the near term and remains our focus over the long term. With those factors in mind, we also want to use this time to set clear and realistic expectations so shareholders and stakeholders can track what progress looks like in 2023.

Taking a step back, I might start by recognizing that our growth in '22 didn't come easily. It wasn't nearly as profitable as we expect it to be over time. In 2020 and 2021, our team put in the effort and the hustle to keep pace with the most turbulent business environment many of us have ever seen. They brought the expertise and excellence to take the company to a new level. But while we gained incredible scale by continuing to prioritize our guests, I acknowledge we're still developing some of the tools to marshal that scale efficiently.

Yet, as we think about what growth looks like from here, it's helpful to anchor back to what we were saying at year-end 2019. At that time, we were putting up proof points on a strategy that was and still is unique in retail, when we built to reliably deliver low single-digit increases in sales year after year. It started by investing in our team, in part because we believe human interaction is the key to growth in a digital age. As we move into 2023, we'll continue to support our team and lean into our culture, knowing they're at the heart of our overall success.

The 2019 strategy put stores at the center of everything. Because when we remodeled or added a store and improved the guest experience, comps grew. At the same time, turning stores into fulfillment hubs was and still is the most efficient and least costly way to grow omnichannel sales. As you'll hear today, we're not standing still on our store remodel and expansion plans or investments in a bigger supply chain or ongoing improvements in digital. It's no surprise that 100% of our store sales are fulfilled by stores. But in our case, more than 95% of all sales, including digital, are, too.

Since 2019, our store base has only grown slightly, but total sales grew nearly 40% in that time frame. Our digital business nearly tripled in size, and our sales per square foot increased by 37%. And fulfilling substantially all that growth through essentially the same asset base was nothing short of incredible on the part of our team. So as we hold on to those gains and look to put growth on top of them, we'll continue to invest in stores, in supply chain, in digital through our stores as hubs model.

Our 2019 strategy prioritized the differentiation and profit performance of an owned brand portfolio that is simply unmatched in retail. At the same time, we're curating national brands our guests love. And in 2019, we had just started our premier partnerships with Levi's and Disney. Since then, both those partnerships have expanded, as have our partnerships, with Apple and Starbucks. And as you know, we're in the middle of building on an incredibly exciting partnership with Ulta Beauty.

Meanwhile, our team has built on our position of strength in owned brands, adding 17 of them since 2019. That includes 2 more \$1 billion-plus brands in Good & Gather and All In Motion. But we're not slowing down with owned brands. In fact, just the opposite. As you'll hear from Christina, we're planning a steady cadence of newness in owned brands and national brands across our multi-category portfolio in the year ahead.

What else was in the 2019 strategy? Well, that was a year we introduced Target Circle. At that time, it was a powerful new asset for guest engagement, personalization, loyalty and sales that quickly attracted 50 million users. Since 2019, the user base has doubled and is still growing meaningfully. And Circle has become the heart of our increasingly connected loyalty ecosystem.

Since 2019, our media company, Roundel, has grown significantly with great additional growth and profit potential on the horizon. It's sought after by advertisers for its relevance and reach, and it's growing each year because our guests appreciate the engagement and the value it delivers. Roundel makes for more deeply engaged guests and partners. And because it gives us better understanding of our guest preferences, it makes us an even better and more profitable retailer. So we intend to place additional emphasis and investment towards Circle and Roundel in 2023, given the growth potential they'll unlock.

So let's pause here, and I'll start to put all this together. While I'm deliberately drawing a connection between 2019 and the year ahead, there's one giant difference, we're starting 2023 on a revenue base of \$109 billion, not the \$78 billion we had back then. There are other big differences, too. Today, we're reporting a full year comp increase in the low single digits, similar to 2019, and unit share gains across all 5 of our core merchandising categories. But unlike 2019, our 3-year revenue growth is \$30-plus billion, not just \$8 billion. And our digital penetration now stands at nearly 19%.

During the pandemic, guests became more attached to Target. And as we deepened engagement with guests, more moved into the ranks of our most engaged, measured by spend, trips and cross-category purchases. Guest engagement is also reflected in a significant increase in transactions since 2019. In fact, those increases started as far back as 2017. And we're positioned to keep growing engagement levels across our guest base even as we focus on expanding that base overall.

So standing here today, my sense is that if a new normal is on the horizon, it will be much more like 2019 than the last 3 years. And as we plan prudently to invest in 2023, we see a return over time to solid and consistent growth with operating income margin rates that should move towards and then begin to move beyond our prepandemic rate of 6% in the next few years.

Today, we'll show you our work for how we arrived at that conclusion. But a spoiler alert, it starts with the strategy. You've seen it many times before, and while the facets on this slide haven't changed, we're prioritizing to accelerate key growth drivers and making changes that will help us respond to the short-term environment, while continuing to advance all elements of our strategy. They all work together to keep our growth trajectory rolling.

Christina will cover that in greater detail, including the focus this year we're placing on the magic of Tar-zhay, on affordable joy and on digital growth, Target Circle, Roundel and our enterprise sustainability strategy, Target Forward. Then John will cover what we're learning from an ongoing operational evolution, what we're testing, what we're in the process of optimizing, what benefits we see from the standpoint of efficiency as we continue to scale. Michael will describe how we're planning cautiously, and we believe appropriately, given the economic challenges we anticipate this year.

But caution doesn't mean cut off from continued growth and progress. In fact, some of the most exciting progress we anticipate will be translating our newfound scale into simpler, more efficient ways to run Target. The difference between an enterprise-wide efficiency mindset and a cost-cutting program starts with what questions you ask yourself. For us, the question isn't, what can we cut? It's how do we make things easier for our team to more efficiently deliver a guest experience, that continues to live up to our brand promise. So we'll invite Mike O'Neil, the leader we tapped to coordinate these efforts across Target, to offer his perspective on efficiency, what it is, what it isn't, how we can drive continuous improvement and what we can unlock with this focus.

We're looking forward to the next hour or so. We recognize that the landscape is unpredictable, and there are plenty of near-term challenges on the horizon. We believe 2023 will be a year in which the durability of our model allows us to flex up the categories and the value proposition that are most relevant to our guests today. We'll double down on execution, so our guests get all they've been promised every time they turn to Target.

And we'll stay focused on gaining share across our portfolio, underpinning all the work we're doing around efficiency, to provide fuel for longer-term growth. We're optimistic about what this team can deliver and realistic about how 2023 will keep challenging us to be agile, resilient and responsive for our guests, our communities, for each other and for our shareholders.

Before we leave here today, our goal is to take you along. So you can see exactly what we're seeing. And with that, let's get going.

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**A. Christina Hennington** - Target Corporation - Executive VP & Chief Growth Officer

Thanks, Brian. Despite the challenges of the past year, Target's differentiated position in retail has never been stronger. With a great assortment, compelling value, an unmatched suite of fulfillment options and a joyful shopping experience, Target continues to drive preference with American shoppers in the face of a turbulent economic and consumer backdrop.

We have continually adapted to the environment around us, delivering ease, value and inspiration to our guests, all at a time when daily doses of joy are needed more than ever. And amidst this volatility, we continue to hone the foundational elements that it takes to be a long-term winner in retail.

Fourth quarter comparable sales grew 0.7% on top of nearly 9% last year. And for the full year, comparable sales grew 2.2% on top of nearly 13% in 2021. While our business has been generating growth on top of growth for years now, the mix of last year's sales looked vastly different than what we had expected.

Throughout 2022, changing attitude towards COVID, followed by the pressure from persistent inflation, caused demand for discretionary categories to slow meaningfully. With this in mind, we've taken a cautious approach to this year's inventory commitments in many of these categories. And we're focusing on the agility of our operating model to adjust should sales trends exceed our expectations.

In light of the volatility we've experienced, I often get the question, what did Target learn from the past year? What I'll share with you today are some of the lessons learned. In short, we've learned that our strategy is working. At the same time, we've come to further appreciate the importance of strong day-to-day execution, combined with the agility required to react even quicker to changing consumer trends. And of course, last year, reinforced the importance of providing every guest with a great shopping experience.

Most of what I'll share today likely won't sound all that different from the playbook we've used for the past few years. That is intentional. For example, our multicategory assortment continues to resonate with our guests, even as consumer demand continuously evolves. The unique balance we've achieved across all five of our core merchandising categories continues to be a key differentiator in the market, with each category serving at times as a trip driver, at other times as a basket builder, and often times as both.

Throughout 2022, we saw and continue to see incredible growth in our Food & Beverage and Essentials & Beauty businesses, offsetting a meaningful pullback in discretionary categories like Home, Apparel and Hardlines. But despite this pullback, these discretionary categories still delivered around \$55 billion in sales last year.

In both our Food & Beverage and Beauty categories, 2022 delivered the third consecutive year of double-digit sales growth, stemming from increases in both traffic and average ticket. And while we're thrilled to have driven unit share gains across all of our major categories last year, we saw the strongest gains in these rapidly growing frequency categories, a proof point of the relevance and value found in these assortments.

In Beauty, we continue to be a market leader, delivering the highest growth rates of any category we sell. We've been seeing outsized growth across the entire portfolio from everyday beauty assortments to new and exciting offerings like those we've added through our partnership with Ulta Beauty. In fact, last year's sales from Ulta Beauty at Target were more than 4x higher than in 2021, and this growth was almost entirely incremental. As such, we remain excited to continue opening additional Ulta Beauty at Target locations this year and beyond.

Of course, we don't build an assortment for a given snapshot in time. Rather, we flex across our categories as consumer demand shifts. And even in tough times, our discretionary assortment provides a unique opportunity to connect with guests in key moments, from major life changes, to seasonal celebrations and everyday moments in between.

Now I want to be clear that despite our cautious inventory position in discretionary categories, we're still focused on delivering newness throughout the portfolio and placing select bets in businesses where we believe market share opportunities are strongest. That's because despite continued volatility the past year reinforced to us that Target guests are attracted to all things trendy and new. We believe our commitment to newness is a key reason why we continue to generate traffic growth, and why we drove broad unit share gains last year.

Our focus on balance can be found within each category as well, where we continue to offer both industry-leading national brands and high-quality affordable owned brands that are unmatched by our competitors. Our owned brands have long been a source of pride and differentiation for Target, offering great style and quality, all at incredible value. So it's no surprise that our owned brands have continued to outpace total enterprise growth and why we have plans to launch new or extend assortments in more than 10 owned brands this year.

Recently, a study listing the 10 fastest-growing private label brands in 2022 included three found exclusively at Target. Target was the only retailer to have more than one brand on the list, and two of them were the only nonfood brands to make the cut.

Many retailers were not focused on newness in 2022, but the opposite was true at Target, where we continue to excite our guests with innovative and trendy products. For example, we launched Future Collective, a first-of-its-kind apparel owned brand, featuring collections in partnership with a rotating roster of diverse influencers. This innovative approach blending the strength of Target's owned brands with the excitement of our limited-time partnerships and collaborations has been a huge success, particularly with Black guests, furthering our commitment to ensure all guests see themselves reflected in our assortments.

Most recently, we launched a new line with actor and influencer, Tabitha Brown. Tabitha's energy and passion absolutely shines in this new line, and our guests are loving it. Tabitha serves as the latest example of the endless possibilities that comes from bringing together the incredible talents of diverse designers and the power of Target's multi-category portfolio.

Take a look and see what I mean.

(presentation)

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**A. Christina Hennington** - Target Corporation - Executive VP & Chief Growth Officer

The passion of these designers is so inspiring, the emotion and pride is palpable, and we love the way the Tar-zhay magic of these partnerships cut across categories, including last quarter's launch of Marks & Spencer and Tabitha's recent extension into food.

And while these collaborations offer joy for our guests, recent history has reinforced that focusing on the basics of retail is just as important as the latest innovation or new offering. In fact, nailing the fundamentals is the bedrock of a successful retailer, from the overall shopping experience to ease and convenience, relevance, everyday value and more.

Of these fundamentals, we know that a strong and reliable shopping experience is the surest way to build trust and affinity. So we aim to provide a consistent, joyous and easy experience, both in stores and online, making Target a shopping destination, not just a means to an end. To do this, we've invested heavily in new stores, our remodel program and our same-day fulfillment services, as John will highlight shortly. We led the way in comprehensive pay and benefits, attracting and retaining the best team in retail, allowing us to provide a level of service unmatched by our competitors.

We've invested in one-of-a-kind brand partnership experiences like those with Levi's, Apple, Disney and Ulta Beauty. And while some of these partnerships are newer, we've featured Starbucks in our stores for decades, proof that when we work with iconic brands, we build lasting relationships.

With a Starbucks in nearly all of our stores, they have become part of the shopping ritual for many of our guests. In fact, we served up more than 170 million Starbucks beverages last year alone.

A strong digital shopping experience is every bit as important as the one we create in our stores. So we've been investing to ensure that the experience is seamless across every channel, regardless of how our guests shop. Whether searching for an item or browsing for inspiration, we continue to elevate their experience, providing personalized and relevant content using our incredible data and guest insights. This will include more customized homepages, improved search functionality and even more personalized offers from Target Circle. It will also include more relevant content from our digital advertising business, Roundel. Our digital success won't be driven by a single service or offering, but through a comprehensive set of experiences designed to be greater than the sum of the parts.

Target Circle is one of the nation's leading loyalty programs with over 100 million members and growing. Through continuous learning and application of guest insights, Target Circle served up 3x more personalized offers in 2022 and Target Circle members spend 3x more on average this past holiday season.

We also continue to invest in the tools, team and capabilities of Roundel. To us, Roundel is more than a digital advertising platform or another revenue source in the P&L. The goal is for our guests to have a tailored, relevant experience, while helping our vendors reach the guests who are most likely to be interested in their products. Said simply, Roundel makes us better merchants, more consistently serving our guests with the products they want. This is why our approach to digital advertising looks different than others. We put our guests at the center of this strategy, just as we do in every other aspect of our business. It's no wonder we continue to see such explosive digital growth, why Roundel grew by more than 60% over the past 2 years, and why we'll continue to leverage the rich guest insights.

And regardless of whether our guests are shopping online or in-store, they are looking for comprehensive value now more than ever. That means offering great everyday prices and promotions and offering quality and inspiration. After all, Target invented affordable joy decades ago and is still a key differentiator in a crowded retail market.

Our guests see value in countless ways, from our competitively priced and high-quality owned brand offerings to multiple RedCard benefits, including 5% off on every trip and free shipping for all online orders, all with no annual fee. We offer compelling value at every turn, and we are continuously listening to our guests to understand what value means to them.

And beyond these retail basics, we continue to hear from our guests that they prefer shopping with companies who prioritize people and planet. That's why we're so focused on our Target Forward strategy. This isn't a standalone strategy, but rather Target Forward is fully integrated throughout our business, fueling our growth potential, while bettering the world.

As part of this strategy, we'll continue to elevate Black voices and brands and are on track to spend \$2 billion on Black-owned businesses by 2025. We'll also continue to focus on designing products for a circular future like in our owned brand, Universal Thread, where we are using materials such as recycled cotton and polyester. These are just a few of the countless examples of how we push ourselves and industry partners to grow sustainably.

Our purpose to help all families discover the joy of everyday life requires a balance of quality, value and innovation that sets us apart from competitors. We are relentless in ensuring every decision supports this delicate balance. It's easy to say, but takes incredible diligence to execute. And while you've heard me say it before, it bears repeating now. We truly have the best team in retail. I'm so grateful for the many efforts of our team to serve our guests and each other, day in and day out.

With that, I'll turn things over to John.

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**John J. Mulligan** - Target Corporation - Executive VP & COO

Thanks, Christina, and good morning, everyone. So Brian talked about the last few years being unpredictable. To put a finer point on that, if you had told me in late 2020, during the height of the pandemic, that 2022 would be the most challenging operating environment in my career, well,

I would have assumed you were joking. Yet shifting consumer preferences, supply chain volatility and rising inflation created a set of conditions that called for flexibility, responsiveness and resilience. Our environment remains volatile, and we expect 2023 will have its own unique set of challenges. But if I've learned anything over the past 3 years, it's to never underestimate the power of a purpose-driven team and the culture they create.

2022 offered more examples of Target teamwork than I can count, but two will stick with me for quite a while. 5 months ago when Hurricane Ian devastated communities across Florida, our team sprang into action. They didn't wait for me or Brian or anyone else on the leadership team to tell them what to do. Instead, they gathered input from those on the ground and told us what they needed. Pop-up resource centers that provided laundry, food, gas, restroom, showers and Wi-Fi-enabled laptops to 700 team members and their families. Extra inventory to stock local stores with essentials guests would need to weather the storm, and financial support, \$5 million to fund local relief efforts and up to \$3 million in matching donations to our team member giving fund, which provides assistance to team members affected by natural disasters.

It was about the same time that our inventory action plan was in full swing. You'll remember, we announced bold measures last summer to quickly take action to rightsize our inventory in response to shifting consumer demands. It was a big ask of our team, one that required them to move quickly and aggressively to reduce existing inventory and cut back on receipts for the back half of 2022. And the team responded as they always do with heart and hustle. They worked through 8 distribution centers worth of inventory in a matter of months, putting us in a strong position heading into the critical holiday season. That's our culture in action, bottom-up ingenuity centered on caring for our team and our guests. And it's that culture that fuels our strategy and growth.

For years now, we've shared our vision of using our stores as fulfillment hubs to get closer to our guests. It was an idea that was novel when we first introduced it, but it's been widely adopted as others expand their view of what stores can do. Now I'm an engineer to my core. So it gives me great satisfaction to see the way Target built our stores as hub strategy from the ground up and how our operating model gets stronger with each passing year.

We don't have a rigid road map. Instead, we use a highly repeatable process to test concepts, refine them, test them again, until we can replicate them with confidence, efficiency and scale. And then and only then do we ask ourselves what's next? And how can we make this even better? And the whole process begins again.

Let's take Drive-Up. You can trace the origins of Drive-Up to the launch of our Store Pickup service a decade ago. It took a few years to get Store Pickup where we wanted and when we did, we were able to take it one step further with Drive-Up. We launched Drive-Up as a test in our Minneapolis market in 2017. By the following year, the service was available in more than 1,000 stores around the country, and it reached all 50 states in 2019.

With the foundation in place and operating at scale, we started to explore new capabilities. In 2020, we made fresh and frozen groceries available. In 2021, we added adult beverage and expanded our app to give guests a more customized experience. Last year, we began testing Starbucks at Drive-Up. And today, we're announcing the next phase of our Drive-Up services with Drive-Up Returns, which started as a pilot last year and will be available across the chain by the end of the summer.

Not only is this a huge win for our guests who can now do even more at Drive-Up, but it brings more efficiency to our returns process, with more resale opportunities and fewer expenses for mail-in returns. We're combining the strength of our digital self-service returns process with our industry-leading Drive-Up experience to meet our guests where they are.

This is what it means to be a truly omnichannel retailer, giving our guests the flexibility, ease and convenience to shop the way that works best for them and scaling capabilities across every facet of our business. Online, in-store, Drive-Up, it doesn't matter how they choose to shop with us. We're here to make their Target run better than ever.

Looking back, the evolution of Drive-Up may seem like it was a natural progression, easy to predict and implement. When you're bringing to market new ideas in an environment that is anything but stable, you have to be ready to adjust course and explore alternatives. Our team has gotten really good at moving in step with the needs of our guests. That flexibility and a commitment to the fundamentals that make or break a retailer, things



like hiring the right people, offering the right products and delivering the right experiences to our guests, underpin our stores as hub strategy and contribute to our larger story of growth.

Same-day services like Drive-Up are a great example. They grew nearly 7% last year as more shoppers appreciated the convenience and speed with which they can check off everything on their list. And because we own our same-day capabilities, pickup and Drive-Up are much more economical and flexible than other forms of digital fulfillment. In fact, our average fulfillment cost per unit has come down 40% over the past 4 years as our same-day services have grown to account for over half of our digital sales.

Again, these results don't happen overnight, and they aren't achieved in a vacuum. They are the product of steady investment and listening to our guests. Take our stores, which sit at the heart of our stores as hub strategy and play a dual role of shopping destination and fulfillment hub. Our stores are not only beautiful, with open floor design, plenty of natural light and design elements that reflect the communities they serve, they're built to keep inventory moving through our system and support Target's trajectory of growth.

Late last year, we introduced a new store prototype in Katy, Texas. From the front entrance to the back room, this 150,000 square foot store is a stunner. Beautiful design elements reflect the local environment and community. Features like natural refrigerants, electric vehicle charging stations and rooftop solar empower our Target Forward sustainability ambitions and get us closer to our goal of net zero emissions by 2040. And a backroom 5x bigger than our average store allows us to ramp up same-day fulfillment, while preserving a seamless experience for our guests and our team.

We plan to open about 20 stores this year in a mix of sizes, from the shores of the outer banks in North Carolina, to the heart of Inglewood, California. We're also planning to invest in about 175 stores throughout the year, ranging from full remodels to the addition of shop-in-shop experiences like Ulta Beauty and retrofitted fulfillment spaces to support our same-day services. Our ongoing investment in our suite of stores is just one way we're building for the future.

What might be less evident to our guests is how we're building facilities behind the scenes to make their experience even better. We've built upstream capacity by opening flow centers in Chicago and New Jersey, with several more slated to open over the next few years. And a new food distribution center that opened in Maryland this past October expand support for our growing food and beverage business. This additional capacity gives us more flexibility to manage inventory and keep our stores stocked with the items guests want when they want them.

We're also making investments downstream. Earlier this month, we announced the expansion of our sortation center network to more than 15 facilities by the end of 2026. These facilities have transformed how we move inventory with speed and precision to guests' doorsteps. We started with a prototype less than 2 years ago to see how we might bring more efficiency to how we sort, batch and route packages. Today, we have 9 sortation centers open across the country, allowing us to deliver packages to guests within 2 days. Up to 40% are delivered 1 day when using our last-mile delivery capabilities with Shipt. And because Shipt is fully integrated into our last-mile operations, we benefit from significantly lower delivery costs.

To give you a closer look at how these sortation centers have become core to our business, we ask leaders from Target and Shipt to give you a brief tour and talk about how our test and learn approach applies to last-mile delivery. Let's take a look.

(presentation)

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**John J. Mulligan** - Target Corporation - Executive VP & COO

As you heard from [Doire], [Thad] and [Kamau], we've learned a lot over the past few years, using every opportunity to improve speed, cost and quality. And in regards, our sortation centers are just hitting their stride. We delivered more than 25 million packages through sortation centers last year, and we expect to double that amount in 2023 with the help of our local and national carriers.

Together, the investments we're making create a more nimble sourcing, inventory management and fulfillment capability at Target, and they continue to help us navigate tough times, prepare for the unpredictable and fuel steady growth, all thanks to our incredible team. We've made

huge strides in recent years to connect with our guests through our stores. The momentum continues to build, and I look forward to sharing progress with you and our guests in the quarters to come.

Michael, I'll turn it over to you.

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**Michael J. Fiddelke** - Target Corporation - Executive VP & CFO

Thanks, John. As Brian mentioned, it was exactly a year ago that we were on this stage, talking about our 2021 financial results, a year in which our business generated double-digit growth in comparable sales and even faster growth in EPS. And as Christina discussed, we knew on that day that the environment was likely to change, but we didn't yet know how dramatic those changes would be. The rapid pace of this transition led to multiple profit pressures on our business, including markdowns and other costs related to last year's inventory actions, significantly higher shipping and domestic transportation costs and higher inventory shrink.

So as we focus on our business plans, both for 2023 and the longer term, it's important to consider how the environment will continue to evolve. On the one hand, many things about life and consumer behavior already look a lot like they did before the pandemic. Students are back in school, sports arenas are full, people are eating out again and consumers are embracing in-store shopping.

At the other extreme, certain aspects of life appear to have changed forever. Many office jobs are now hybrid, with remote work and virtual meetings playing a much more significant role. That means many of us are spending a lot more time working at home, which has implications for long-term buying patterns in multiple categories, most notably our Food business.

Fulfillment mix has also seen a permanent shift. Our same-day services have seen explosive growth. They now account for more than half of our digital sales and more than 10% of our total sales. And that trend shows no signs of reversing. Even as people have remixed their trips in favor of in-store shopping, guest engagement with these digital services has continued to grow on top of the huge expansion that's occurred over the last few years.

Most importantly, our guests' overall engagement with Target has increased significantly over the last few years, and it continues to grow. Think about it this way. In 2021, guests made about 2 billion trips to Target, which was about 300 million higher than in 2019. And last year, even as consumer spending moved away from products into services, traffic grew again. The deeper relationship we've established with our guests and our proven ability to deepen it further are some of the many reasons we're so well positioned to deliver profitable growth in the years ahead.

Beyond the factors that have changed permanently, there are several others that are clearly still in transition. These include transportation and the global supply chain, where we've already seen remarkable improvement, but we're still facing elevated costs and variability compared to the prepandemic period. Another factor is inventory shrink, which has increased broadly across U.S. retail over the past 2 years. And finally, the most significant and important driver of uncertainty today is the fact that the broad macro economy is still in transition, leading to an inflationary period, more pronounced than we've seen in decades.

As Christina mentioned, rapidly rising prices have put pressure on discretionary spending as consumers make room for higher prices on necessities. In addition, higher interest rates have further pressured budgets by increasing the cost of mortgages and car loans.

So where does that leave us today? Despite all of the recent turmoil and the pressures facing our business, we remain in a very strong position to drive healthy growth in the coming years. Our guests are more engaged than ever, and that engagement continued to grow even during a tumultuous year. And even after a year in which we experienced unique and unexpected headwinds to both our profitability and cash flow, our business is sound, it remains strong and we're laser-focused on the path forward.

In 2023, we'll focus first on agility and strong execution. Most notably, we'll take a cautious stance on our inventory commitments in markdown-sensitive categories, with the flexibility to sell into our base inventory and expand receipts over time. At the same time, we'll continue investing in our long-term strategic initiatives that propel our market share and profit growth, including our remodel program, our new store pipeline and projects to add replenishment capacity and increased efficiency in our supply chain.

We'll also focus on strengthening our balance sheet. In 2022, our business was a net user of cash for the first time in many years. This was driven by a host of unique factors, including unexpectedly low profitability, higher-than-expected CapEx driven by inflation and project costs and a rapid slowdown in inventory turns due to excess inventory and longer lead times in global shipping.

This year, we expect each of those factors to become more favorable. More specifically, we're expecting an increase in profit dollars and a somewhat slower pace of CapEx. And given our cautious inventory positioning and rapidly improving lead times in global shipping, we're planning for faster inventory turns in 2023, driving higher payables leverage and recovery in working capital as we move through the year.

In the near term, until those expectations play out and our cash generation increases, we're not planning to repurchase any shares, consistent with our goal to maintain our middle A credit ratings. Over time, as our cash flow recovers and our debt metrics improve, we expect share repurchases will play a meaningful role within our broader, long-term capital deployment priorities. But as always, those repurchases will only occur after we fully invested in our business and supported our team, after we've supported our dividend goals and within the limits of our middle A ratings.

Now I want to share some thoughts on our 2023 outlook, and I'll start with our expectations for the first quarter. Given the current conditions we're facing, we expect our business to generate first quarter comparable sales in a wide range, from a low single-digit decline to a low single-digit increase. This reflects our expectation for continued strength in our frequency businesses, offset by softness in discretionary categories.

On the operating income line, we're expecting a first quarter rate in the 4% to 5% range, higher than what we saw in the fourth quarter, but down somewhat from the 5.3% our business generated in last year's first quarter. While there are a number of factors driving this expectation, I'd note that our first quarter SG&A expense rate is expected to be about 1 percentage point higher than a year ago, reflecting continued investments in our team and guest experience, without an expected leverage benefit from higher sales. Altogether, on the bottom line, we expect our business to generate first quarter GAAP and adjusted EPS in a range from \$1.50 to \$1.90.

Now I'll turn to our full year expectations, and I'll first note that the range of potential outcomes gets wider as the year goes on, given the high degree of uncertainty regarding the strength of the economy and the consumer. Given this uncertainty, we firmly believe caution is the appropriate posture, especially when planning sales and inventory in discretionary categories.

On the frequency side of the business, our full year plans envision continued share gains and strong sales growth. But we're mindful that inflation in these categories may begin to moderate, pressuring dollar comps across the industry. In light of those considerations, along with our outlook for discretionary categories, we're planning for the same wide range on the top line that we're planning for the first quarter, from a low single-digit decline to a low single-digit increase in our comparable sales.

In terms of profitability, the range of potential outcomes is similarly wide. As I mentioned earlier, we're positioned to benefit from a number of significant tailwinds on the gross margin line, most notably as we cycle over last year's inventory actions. In addition, we're expecting hundreds of millions of dollars of additional opportunity from lapping last year's unusually high freight and transportation costs.

At the same time, we're also preparing for some notable headwinds on the gross margin line. These include inventory shrink, which may continue to rise before we see rates begin to moderate over time. We're also expecting some pressure from soft sales in our highest-margin discretionary categories. And finally, we see the potential for increased promotional intensity across the industry this year, given that we're competing in a constrained environment for consumer spending.

On the SG&A line this year, we expect continued strong discipline in managing costs across the enterprise, but we're also not backing away from investments in our team and guest experience, and we'll face potential rate deleverage given our outlook for comparable sales.

In light of these considerations, we're planning for a wide range of potential outcomes for our full year operating income. But even at the low end of those expectations, we expect to grow our operating income by more than \$1 billion this year. Altogether, our expectations translate to a full year GAAP and adjusted EPS range of \$7.75 to \$8.75, which represents growth of about \$1.75 per share at the low end of the range.

On the CapEx line this year, we're expecting to invest between \$4 billion and \$5 billion. While this range is somewhat lower than last year's CapEx, it's quite strong relative to our history. This year's plan reflects the optimal level to invest in the current environment and our expectation that we'll continue to earn high returns on our long-term growth investments, including our remodel program and new store pipeline and our continued work to build capacity and capabilities in our supply chain.

As we think about the longer-term trajectory of our business, we expect that as external conditions normalize in the next several years, our operating income margin rate should reach and begin to move beyond our prepandemic rate of 6%. This return to prepandemic levels could happen as early as 2024, depending on the speed of recovery for the economy and consumer demand.

I want to pause and emphasize that this year's guidance does not reflect how we expect our business to perform over the longer term. Once we see a normalization of consumer demand and a resumption of growth in discretionary categories, you'll see that reflected in a stronger top line performance and a meaningful increase in our operating margin rate beyond what we're planning for this year.

I also want to reiterate something we've said many times. While we often talk about rates because it's helpful for analytical purposes, our goal is to find the optimal rate that maximizes profit dollar growth over time. In other words, we'll continue to focus simultaneously on top line growth and the rate we earn on it without focusing on either metric in isolation.

So now before I invite Brian and Mike O'Neil to join me on stage, I want to pause and thank our team for their continued optimism and resilience through a turbulent year. Last year presented a host of unexpected and unprecedented challenges that all seemed to arrive at once. Through it all, our team maintained a long-term focus, serving our guests and taking care of each other.

As a result, we saw continued expansion in guest traffic and engagement throughout the year and historically strong hiring and retention metrics across our team. Those are some of the most important factors in determining our long-term success and why I feel so confident about Target's potential in the years ahead.

Now I'd like to invite Brian and Mike O'Neil to join me on stage so we can have a brief conversation about the enterprise efficiency work we've asked Mike to lead.

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**Brian C. Cornell** - *Target Corporation - Chairman of the Board & CEO*

Well, Michael, thank you, and Mike, thanks for joining us today. I know everyone would like to get into the work, but I think it would be really helpful to just pause for a second and talk about your background and why we selected you to lead this very important initiative.

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**Michael O'Neil** - *Target Corporation - SVP of Enterprise Efficiency*

Yes. Thanks, Brian. Really happy to be here and excited about the opportunity to lead this work for Target. I've been at Target now for 15-plus years, started in finance, worked in various roles with our merchandising operation partners to help deliver on their strategic priorities and their financial growth. Through that experience, I got to see the business model through the lens of the P&L.

A couple of years ago, I went over then to human resources and led our pay and benefits and strategic workforce planning teams. And that was a great opportunity to see the business through the lens of our team members. I had a chance to lead that team during the early days of the pandemic and saw quickly the work our team does to take -- the importance of taking care of them to take care of our guests.

From there, I've been back now in finance for a couple of years, and was leading the financial planning and analysis teams where we work with every business function to deliver on both our finance and strategic priorities. And coming back to finance and seeing the growth we've seen over the last couple of years, it was pretty apparent to me the opportunity to step back and think about how do we run this business model now at the larger scale. And so I think with those experiences, plus the relationships I've built over these 15 years, I think, position me well to lead this work forward.

**Michael J. Fiddelke** - Target Corporation - Executive VP & CFO

Mike, when you took on this role, we spent a lot of time talking about what this work's about and what it isn't. Can you share a bit about the reasons we've initiated the work and what we're looking to accomplish?

**Michael O'Neil** - Target Corporation - SVP of Enterprise Efficiency

Yes. I think I'll start maybe with what it isn't. This isn't about sacrificing long-term growth for short-term profits. A typical tactic here is to look to shrink your cost base in the face of declining revenues. Well, that's not Target, right? We are growing, continue to grow. In fact, this work has come out from the growth we've seen over the last 3 years. We've grown \$30 billion -- over \$30 billion since 2019. That's more than 14 years prior. And that creates a tremendous opportunity to step back and reimagine how do we operate this business at a larger scale, but more importantly, how do we position Target for future growth.

And so as we're looking for efficiencies, we'll look for ways to simplify the work, to streamline processes, to reduce redundancy, all with the mind of how do we make it easier for our team members to deliver a great guest experience. In doing so, our initial scoping says, we'll deliver \$2 billion to \$3 billion of cost savings over the next 3 years.

**Michael J. Fiddelke** - Target Corporation - Executive VP & CFO

Mike, I want to clarify one thing briefly. After Brian and I mentioned this effort in our last earnings call, we got some questions about whether that \$2 billion to \$3 billion number includes the natural recovery from the headwinds we experienced in 2022. Can you help clarify that?

**Michael O'Neil** - Target Corporation - SVP of Enterprise Efficiency

Sure. I've got a couple of those questions as well. And I would say, I reiterate that this is not about the work over -- or what's happened to us over the last 12 months. It's about the growth that we've seen over the last 3 years. And so no, what's not included is anything that will come, the natural recovery from the headwinds of last year. This work is the designed to deliver fuel beyond that, both to deliver on our -- both our top line and our bottom line goals.

**Brian C. Cornell** - Target Corporation - Chairman of the Board & CEO

Mike, when we asked you to lead this project, we spent a lot of time thinking about the guardrails. Now obviously, there's big opportunities that we want to capture. But there's also things we never want to compromise. Do you want to talk about the opportunities versus the guardrail of let's say, "We'll never head in this direction?"

**Michael O'Neil** - Target Corporation - SVP of Enterprise Efficiency

Yes, I think that's a really important question. And the things we're not willing to sacrifice start with a team member and the guest experience. We're not going to take away anything given the investments we've made in our team over the last couple of years, and spending that time in human resources during those early days of the pandemic had an appreciation for all our team did to run our business and to serve our guests. And so I look at our team members and the investments we make as an investment in the best team in retail.

Similarly, on the guest side, our shopping experience is a key differentiator for Target, and we're not looking at anything to take away from that. In fact, our guiding principle around this work is, how do you make it easier for our team members to run our business and in doing so, deliver a great guest experience? And so we do that, we think we'll see benefits to both the team and our guests.

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**Michael J. Fiddelke** - Target Corporation - Executive VP & CFO

Mike, since we first announced this work, I've had a bunch of investors ask me where they should expect to see the results of this work show up in the P&L? Can you share your initial thoughts?

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**Michael O'Neil** - Target Corporation - SVP of Enterprise Efficiency

Sure. I think it's -- you're going to see it across the full P&L. So I'm not sure you're going to be isolating it to one single component. What excites me about this work, though, as we think about running the different scale, I think there's top line opportunity. And so it's going to start with sales. Now we're not going to do anything against the -- we're going to continue to invest in our team, but any efficiency work will have SG&A impact on the SG&A line. And product costs continue to be our biggest line item on the P&L, so we'll see it there as well. But I also will say it'll expand beyond the P&L as we look to be more efficient in our CapEx.

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**Brian C. Cornell** - Target Corporation - Chairman of the Board & CEO

So Mike, I know you're still in the early stages of scoping the work, but there's also things that we've been working on for quite some time now that we can build on. Do you want to highlight some of those?

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**Michael O'Neil** - Target Corporation - SVP of Enterprise Efficiency

Sure. We touched base on a lot this morning that work around digital fulfillment, I think, is a great example. We've been -- that work in several years underway, when you think about our stores as hub model, has significantly decreased our fulfillment cost. John mentioned 40% over 3 years.

We've also been able to increase speed of delivery and improved the guest experience across all those different nodes, whether that's ship-to-home, Drive-Up, Order Pick up or Shipt delivery, and it's extremely capital efficient.

If you look forward now, we think there's hundreds of million dollars to continue to unlock with our investment in sortation centers. That's a business -- that's a capability that's been on our road map for a few years now, but requires scale and density at the market level to unlock. And given the growth over the last 3 years, we now have that.

And so we think there's opportunity in a dozen of metro markets. We already have 9 facilities out there and plan to have a total of 15 by 2026. And so we'll open those up, but also we'll make those centers more efficient as well as we think about streamlining processes in them and looking to introduce automation and technology.

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**Michael J. Fiddelke** - Target Corporation - Executive VP & CFO

Thanks, Mike. Can you also provide an example of a newer effort you're excited about?

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**Michael O'Neil** - Target Corporation - SVP of Enterprise Efficiency

Yes. I think the best example is the work that's underway now in Apparel. This one is near and dear to my heart. My first role at Target was the finance partner for our women's apparel business. I also think it serves as a really great example of what is possible with this work. Apparel, just like the rest of our business, has seen explosive growth. We've grown over \$3 billion and now a over \$17 billion business in Apparel business. It also has its unique complexities, right, from the fact that we partner with vendors to source raw materials, to the fact that we have unique fixtures in store for presentation. So all the geographical and weather and demographic considerations that go into assortment planning and allocation.

And so that growth, combined with that complexity, makes a tremendous opportunity to step back and say, how do we run this business at a larger scale and how do we position it for future growth? And so we're focused right now on driving simplicity, speed and consistency across the entire pair of value chain. And in doing so, we expect to see benefits from assortment planning, to supply chain, all the way down to guest fulfillment.

And the benefits will be across the P&L. We'll see it in lower markdowns, we'll see it in increased productivity -- labor productivity, and we'll see it in top line sales. And so I love that example because it gives you a chance to step back and say, look, we've seen this growth over the last 3 years. How do we look end-to-end across the value chain to position it differently? How do we simplify for the work for our guests? And in doing so, we believe we'll see benefits across the P&L with the most important one being top line sales.

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**Brian C. Cornell** - Target Corporation - Chairman of the Board & CEO

So Mike, I love the way you framed this up. This is all about fueling future growth, driving simplicity, reducing complexity, never compromising the guest experience and the role our teams play. Are there any other components as you think about this, that you want to touch upon?

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**Michael O'Neil** - Target Corporation - SVP of Enterprise Efficiency

Well, I'd say thanks for letting me come up to share just a couple of examples. I would say -- I'd reiterate is this starts with growth. It starts about how do we make it simple and easier for our team members to deliver a great experience. And that work is going to be a multiyear journey, and this will require end-to-end problem solving across the value chain. But when we do that, we focus on making a better team member experience. We'll see a better impact to our team, our guests and our P&L.

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**Brian C. Cornell** - Target Corporation - Chairman of the Board & CEO

Well, Mike, I want to thank you for joining us on stage here today. We're really excited about the opportunities that are in front of us. You've heard a few examples today, and we'll continue to provide updates along the way.

So Mike, thank you for joining us.

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**Michael O'Neil** - Target Corporation - SVP of Enterprise Efficiency

Thanks, Brian.

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**Brian C. Cornell** - Target Corporation - Chairman of the Board & CEO

Michael, I'll have you back here in a second.

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**Michael J. Fiddelke** - Target Corporation - Executive VP & CFO

Great.

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**Brian C. Cornell** - Target Corporation - Chairman of the Board & CEO

So as we get ready to hear from you and take your questions, I thought I'd briefly recap some of the themes you've heard today. First, our commitment to our guests is as strong as ever. Second, our strategy, our multi-category portfolio, our stores as hub model will provide the flexibility we need to keep growing because we're going to stay closely connected to our guests. Finally, there have been some fundamental changes at Target over

the last 3 years. We're more than \$30 billion bigger. We set the omnichannel standard with stores as hubs. We'll continue to build and innovate in that realm. We'll set the pace in supporting and developing the very best team in retail.

Perhaps the most important takeaway is something that hasn't changed, and that's our ability to shift our business and our categories in step with our guests. If they need to prioritize food and essentials, we'll lean into those categories. But as you heard from Christina, in a year when discretionary spending was down, our discretionary categories generated \$55 billion in sales. Our guests today are responding to newness. They're celebrating seasons as we just saw with Valentine's Day. They're eager to be out in our stores and enjoying that guest experience, and we're seeing it in our traffic growth. And we know they really value affordable joy.

So we remain fully committed to our multi-category portfolio, to essentials and to our discretionary categories. And as our guests lean back in discretionary categories over time, we'll be ready to flex into those trends, building substantially on the near-term plans we share today.

We know that will happen. But in the meantime, we're moving forward thoughtfully. We're doubling down on retail fundamentals. We're finding fuel for further growth through efficiency. And while we're emphasizing prudence in our near-term performance, I am incredibly positive about the long-term potential and our ability to translate both into positive outcomes for all stakeholders, including shareholder returns over time.

So I want to close by thanking our team as they tune in from around the globe, and thanking all of you for staying with us on this journey.

And with that, I'll ask Christina, John and Michael to come back, and we'll open it up for your questions.

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## QUESTIONS AND ANSWERS

**Brian C. Cornell** - *Target Corporation - Chairman of the Board & CEO*

All right. I see hands already going up. We've got paddle runners around the room. As I call on you, I might ask you just to pause, introduce yourself and ask your question. So why don't we start right here. Michael?

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

It's Michael Lasser from UBS. A few questions. Number one, last year at this meeting, you had talked about an 8% operating margin. So what has changed this year to -- last year to this year structurally with the business to make it a lower operating margin business?

Two, what is it going to take to get to the 6% operating margin by next year? And third, Brian, sorry, did you look at the experience over the last few quarters and say, hey, we missed what we expected it to do. So let's take a more conservative, cautious view on how we're planning this year, leaving potential room for upside?

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**Brian C. Cornell** - *Target Corporation - Chairman of the Board & CEO*

Michael, why don't I ask you to start, and then I'll come back and answer the back half of that question.

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**Michael J. Fiddelke** - *Target Corporation - Executive VP & CFO*

Yes. So we've got a journey in front of us on the profit front, and 2023 plays an important role in stepping back to where we expect to get over time. When we guided to a wide range today, even at the low end, we expect over \$1 billion in net income growth year-over-year. And we want to execute that plan, that's first and foremost. Under the right set of conditions, we think we can get to 6% in 2024. And then we'll take it from there. But we've got the next couple of years squarely in focus because we've got work to do to recover our performance from last year.



As we think about what's optimal over time, I'll go back to what I said in remarks, we want the optimal rate that maximizes profit dollar growth over time. And I think there's still a few variables that will click into place between now and when we have that conversation in the quarters and months to come. But we want to be focused on dollars, in dollar growth, philosophically, that's the thing that we'd leave the group with today.

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**Brian C. Cornell** - *Target Corporation - Chairman of the Board & CEO*

And Michael, back to lessons learned from last year. We've used the term uncertainty quite a bit today. We recognized last year that the consumer trends move very quickly. And one of the things I'm most proud of is the way this leadership team embraced the challenge, took it head on, made the adjustments in our inventory and protected the guest experience. That's why we continue to see traffic growth and unit share gains across our portfolio and why we're so well positioned today for 2023 with overall inventory down 3%, but importantly, discretionary inventory down 13%.

So lessons learned for us, but I'm incredibly proud of the way this team dealt with that issue upfront, protected our team, protected our guests and position us for the long term.

Why don't we go over on this side.

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**Paul Lawrence Lejuez** - *Citigroup Inc., Research Division - MD and Senior Analyst*

Paul Lejuez, Citigroup. A couple of questions on Drive-Up returns. Curious what percent of your returns are done at store? Also what is your typical attach rate? When you get somebody in a store that would return an item, do you also convert them to sales? Is there a risk that you might give up that opportunity? And then second, just high level, free cash flow. Once you get through all the working capital changes in F '23, what does free cash flow look like in your view for this upcoming year?

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**Brian C. Cornell** - *Target Corporation - Chairman of the Board & CEO*

All right. So several questions to answer there. John, I might ask you to start and explain why we're so excited about the changes we're making with returns through Drive-Up. And then Michael, we can talk about the second part of the question.

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**John J. Mulligan** - *Target Corporation - Executive VP & COO*

Yes. The majority of returns come back to store, but a meaningful portion are still shipped back to us. So that's not insignificant. As it relates to your -- the second part of your question around attach rate, and this is the question when we started Order Pick Up and when we started Drive-Up. And to us, that's respectfully not an important consideration.

What is important is allow the guests to interact with us how they choose. And at every step when they see us -- when we see them jump into Drive-Up, when we see them use Shipt, when they -- we see them use Pick Up, their engagement with Target increases, not just digitally, but also in-store, and that becomes a better guest for Target. The best guest set for Target are the ones that interact with all of our various ways of interacting with them.

And so this provides them another opportunity to create ease. You've got your kid in the back. I need some milk and I got to return this, whatever, at Target. I put that in my trunk. I show up. They bring the milk, they take that away and I'm off on my day again. And then on Saturday, we'll come in and do the stock-up trip and that will be great. So our approach is just to continue to lean into where they want us to go.

Top two feedback things on Drive-Up, why can't I get my coffee? Why can't I get a Starbucks? And why can't I return something? And so we're still working on the Starbucks, but we're ready for returns. And again, if we listen to the guests, they'll engage with us.

**Brian C. Cornell** - *Target Corporation - Chairman of the Board & CEO*

Yes. John, I think one of the things we've learned over the last 3 years, and we watched it carefully as we expanded Drive-Up and Pick Up and started delivering right to your home with Shipt, we said, all right, is this going to impact the guest engagement in store? It's quite the opposite. As guests use all of our capabilities, they actually spend more dollars in-store and just reward us with more trips. So it's been an important learning that we'll build on. And I think we'll just deepen that engagement as we give them another easy solution for returns.

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**Michael J. Fiddelke** - *Target Corporation - Executive VP & CFO*

Yes. Just -- at risk of piling on. We care about economics at the transaction level. We care about the economics at the category level. We care about the economics at the fulfillment path. But the thing that we thought differently about over time is cutting the economics by guests. When we take friction out of the process and make it easier for guests to just fall more and more in love with Target, that's the most powerful economic relationship to be focused on. I think we've learned that time and time again, and Drive-Up is a perfect example.

On the free cash flow question, we're not guiding to free cash flow specifically, but we expect material improvement from a free cash flow basis. And I touched on some of the drivers. The first is better profitability. The second is we expect working capital recovery. I mean our turns slowed, our supply chain times were longer this year and that came with working capital investments to make sure we're getting product here early enough with a volatile supply chain. And so we were running at suboptimal working capital levels through the bulk of 2022. As we move through 2023, I would expect that to improve.

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**Brian C. Cornell** - *Target Corporation - Chairman of the Board & CEO*

I think I see a hand up right in this first row. In fact, quite a few. We'll start right in the middle.

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

Simeon Gutman, Morgan Stanley. You mentioned that fulfillment costs, I think, on digital are down 40% since 2019. Is there any merit to the fact that you're a \$110 billion sales organization and that you've suddenly become less efficient such that this path back to 6% requires investments? And so the ultimate question is how much of getting back is the pure recapture of lapping markdowns, freight costs, shrink versus how much you have to invest to get back to that level?

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**Brian C. Cornell** - *Target Corporation - Chairman of the Board & CEO*

Yes, I'm happy to start. It's a piece of both. We've seen some structural changes in the business. We talked about shrink as being one, and that's not one that we expect to turn in a different direction quickly. But the efficiency we've been able to drive, given how efficient stores are as a fulfillment hub is a huge advantage to us when it comes to digital fulfillment. It's fast for the guest, the economics of it work for us and we build engagement like we talked about before.

Separately, we continue to be focused, as Mike shared, on the efficiency work. And that's important work. We want fuel from efficiency, to keep investing in growth of the business. And that will also play a role in getting us to the right profit outcome that we should have as a \$100-plus billion retailer.

Go ahead, Mike.

**Michael J. Fiddelke** - Target Corporation - Executive VP & CFO

Sorry, Brian. I'd add on as it relates to capacity, particularly because you brought up fulfillment, we've seen our sales productivity in the store increase by 37% over the last 3 years, Brian mentioned that. We still have -- so an average store has gone, call it from \$40 million to \$55 million over the last 3 years. We still have stores that do over \$100 million and do well over \$100 million. The top quartile does significantly more than the median store.

So we have tons of capacity sitting out there unused in our stores and the ability to turn faster, again, back to we need to improve how we move inventory and how quickly we move inventory, which we're on the journey on, but our stores have significant capacity to continue to drive both in-store sales and our digital business.

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**Brian C. Cornell** - Target Corporation - Chairman of the Board & CEO

Why don't we go in the back?

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**Unidentified Analyst**

Brian, I'd like to talk a little bit about the trade down impacts you're seeing. Are you a net gainer or donor on the trade down? And to the extent you are losing some share there, do you have -- does your customer database allow you to adopt win-back strategies targeted to those people who may have traded out?

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**Brian C. Cornell** - Target Corporation - Chairman of the Board & CEO

Okay. Christina, do you want to talk about what we're seeing as far as guest shopping behavior?

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**A. Christina Hennington** - Target Corporation - Executive VP & Chief Growth Officer

Yes, happy to. First of all, over the last couple of years, we've gained a tremendous amount of new guests into the Target ecosystem. And so our focus right now has been to deepen our engagement with the guests. Of course, we always want more guests, but the opportunity in front of us is much more to convert them into using the suite of capabilities because they become much more loyal. They understand the Target value proposition more deeply once they experience the ease and convenience of Drive-Up or once they recognized what an incredible food and beverage offering we have. And so that's our primary focus right now.

When we talk about trade down, those are words that are used in many different facets. Sometimes it's used internally in talking about private label. For us, we talk about owned brands rather than private label because these are brands we've invested in for years. We build them, design them, create the packaging, the marketing materials, and they're hugely important to our strategy.

And so in that sense, we never think about it as trade down. We think about it as trade in. It creates more options for people to use and engage with our portfolio because it tends to be the same great quality at incredible price points. And so the growth of our owned brand strategy would reflect significant potential in the future based on the success we've had in the past.

So right now, our focus is to make sure our guests are aware of what we have and create a better, less frictionless experience, make sure that we deepen the loyalty with the consumer.

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**Brian C. Cornell** - Target Corporation - Chairman of the Board & CEO

Right. Moving right here.

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

Right. Maybe I'll just -- I'll jump in. Greg Melich. I got the mic. I'll just do it.

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**Brian C. Cornell** - *Target Corporation - Chairman of the Board & CEO*

You got the mic. The power of the mic, Greg.

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

Really two questions. John, maybe -- well, maybe, Michael, if you could help us on some of the other margin drivers that you see, particularly shrink, you called out is still a headwind. What do you do to actually fix that? I'm also thinking credit profitability now that some of the delinquency rates and other charges are changing.

And then maybe bigger picture, Brian, how important is keeping traffic? You've gained so much traffic and customer engagement. How do you think about pulling that lever versus promotion and margin and expect more, pay less? Is it critical that traffic keeps growing no matter what? Or could it slip 1% or 2% just given your mix? How do you think about pulling those levers as we go through this uncertain year or 2?

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**Brian C. Cornell** - *Target Corporation - Chairman of the Board & CEO*

Michael, why don't I start with the focus on traffic. And as we sit here today, and you've heard me talk about this for years and years now, we think one of the most important indicator of a retailer's health is the traffic indicator. And that's why we feel so good about the fact that we've had 23 consecutive quarters where we've seen comp store sales growth, and it's all on the back of traffic. We're getting more footsteps into our stores, more visits to our site, greater engagement. Our guests are spending more with us. They are rewarding us with more trips and they're shopping more categories. And we think that's critically important.

To John's point, while we've seen a significant lift over the last few years in our sales per square foot, we know there's still potential to go further. And as we think about capabilities like Target Circle, our ability to connect with those guests and deepen their relationship, introduce them to newness in our assortment in other categories, we think we have a tremendous opportunity in front of us.

But sitting here today, I continue to believe looking at trips is critically important. And in an inflationary environment that we're working in today, it's why we're so laser-focused on unit share improvement because those things are going to be really important as we move to a more normalized environment, because the guest is turning to us more frequently for all of their needs, both frequency and discretionary. They're shopping more categories. So making sure we're looking at units carefully, looking at trips to me is a key indicator of the health of our business today and why we're so excited about the potential in front of us.

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**John J. Mulligan** - *Target Corporation - Executive VP & COO*

And maybe for the second part of your question, Greg, when it comes to margin and profitability in general, it starts with what Brian did. The strength of the top line is going to matter a lot and we feel encouraged by the traffic trends that we've seen.

In terms of the other structural buckets, you hit on a few of them. We talked about shrink. We've seen a normalization in some of the credit metrics we watch, I think consistent with what you'd see in the industry. I wouldn't put that highest on the list of factors for next year, but it's one we'll stay close to and monitor.

We've also talked and some of what we covered earlier today, we expect a promotional environment next year. We see guests responding to promotion in the fourth quarter, and we expect that, that's something that could continue. We'll also have some tailwinds on the margin side

though. I mean we're anniversary-ing a level of markdowns in salvage that was extremely typical for us, and we want to make sure we recover that. We've seen some improvement in supply chain and freight. And so as we anniversary some of the peaks from last year, that should be a good guy on the margin line. And so it's all of those variables that we factored into the guidance we gave today.

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**Brian C. Cornell** - *Target Corporation - Chairman of the Board & CEO*

Okay. Why don't we go back there.

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**Ivan Philip Feinseth** - *Tigress Financial Partners LLC, Research Division - Director of Research*

Ivan Feinseth, Tigress Financial Partners. I have two questions. Could you go into some detail on how Roundel contributes to revenue growth? What percentage of your vendors are on it? And how you demonstrate your value proposition to them?

And then my second question, this morning on your interview on CNBC, you spoke about your strength in toys and your growth in home goods. What other category opportunities do you see that, going forward, you could lever and become a retailer of choice in those categories?

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**Brian C. Cornell** - *Target Corporation - Chairman of the Board & CEO*

Right. Well, Christina, I'll let you talk a bit about Roundel and just how important it's been for our vendor partners and deepening engagement. But the second question is something we talk about all the time. And sitting here today, you and I both know, while we have built great momentum and added over \$30 billion of growth, we know we still have category opportunities all around us.

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**A. Christina Hennington** - *Target Corporation - Executive VP & Chief Growth Officer*

Yes. So first, Roundel, like I mentioned in my prepared remarks, is an incredibly important part of our ecosystem. It gives our vendors an opportunity to target the guests that they see as most likely to be intrigued by their new products and the quality of merchandise that they're bringing to market. It allows us to highlight those products and give them real-time insights about how it's selling because of the closed loop reporting that we can offer.

And so this has been a huge part of the demand generation for a lot of our businesses. We are very engaged with a broad spectrum of vendors across the entirety of the portfolio, and believe that Roundel is going to be an important part of the future, partly because of that guest-centricity that we bring to the model, but also because our guests want to know what's new and relevant, both across owned brands and national brands and how it fits into their lives.

So maybe I can pivot to that second question and really talk about what opportunities we have. Well, we have a broad portfolio. And we think the strength of our multi-category portfolio is a differentiator in the market. We don't build an assortment for a snapshot in time. So having a healthy business across every dimension, allows us to flex as market conditions change.

Right now, we're flexing into Essentials & Beauty and Food & Beverage. But a couple of years ago, it was Home and Hardlines that took the center stage. So having the ability to connect with consumers and having relevance and strong market share positions in many businesses is important to us. The way that we continue to build relevance is by staying super guest-centric, working to make sure that we are a destination for seasonal businesses. Seasonal businesses are kind of in our core DNA because it's a great way for guests to do more in one store at one time. Everything you need for back-to-school. You can get your backpack. You can get your calculator. You can get your pens and paper. You can get your new outfit.

So those are really important to us, but the other is the importance of newness. And you heard me talk a lot about that. They're in an environment where consumers are making trade-offs. More of the same is not going to get it done. And so really investing in innovation and something that

excites them, like our Apparel floor pad right now, if you haven't been in our stores or on our site lately, go check it out. The colors, the styles, the aesthetics are right on and it's absolutely grabbing the attention of our guests.

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**Brian C. Cornell** - *Target Corporation - Chairman of the Board & CEO*

Yes. I want to go back to the heart of your question. Do we have opportunities to continue to grow share? And it's something that Michael and I talked to many of you about all the time. Despite the growth we've seen over the last few years, adding well over \$30 billion of top line growth, sitting here today, we represent 3% of the retail market. So as a leadership team, we see opportunities to grow across our entire multi-category portfolio, continue to leverage growth in store and from a digital standpoint.

So while we've seen tremendous progress and we're proud of the way we've transformed the business, we still see a significant runway to take share across every one of our major categories going forward, leveraging that great in-store guest experience and the digital experience we offer, that great combination of inspiration and ease that makes Target such a great destination for guests across the country. So we see tremendous opportunities for years to come to continue to bolster our share position.

Let's come back to the front row. I know your hands have been up for a while.

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**Edward James Yruma** - *Piper Sandler & Co., Research Division - MD & Senior Research Analyst*

Ed Yruma from Piper Sandler. It sounds like Beauty has been a real strong category for you. Can you click down a little bit more on Ulta, maybe the difference in performance there versus non-Ulta stores? And maybe why not move faster? And then just as a quick follow-up on the \$2 billion to \$3 billion in efficiency gains, do you have any of that baked into '23?

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**Brian C. Cornell** - *Target Corporation - Chairman of the Board & CEO*

Christina, you want to start and talk about Beauty? And then Michael, we can talk about '23.

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**A. Christina Hennington** - *Target Corporation - Executive VP & Chief Growth Officer*

Yes. First and foremost, Beauty at Target has been a success story for a number of years. We have an incredible assortment that's been relevant for a while. But adding Ulta Beauty has completed our assortment. Our ability to offer prestige products in our store with a servicing experience and expertise that Ulta has brought to the table has been the missing link. And so we've completed that picture.

And so really excited about the performance, really excited about our partnership and we're looking to accelerate. We're already at 350 stores, and we'll add more, as John talked about, as part of our remodel program. So really bullish about the future there.

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**Brian C. Cornell** - *Target Corporation - Chairman of the Board & CEO*

Yes. Ed, you and I actually walked a store recently. And I think you heard from our local team, the fact that very excited about the results we're seeing with Ulta Beauty and it's clearly driving even more traffic to Target. But at the same time, that team talked to you about the fact that our core beauty assortment continues to grow. So they're complementing each other, and we're just becoming more and more destination for that beauty shopper.

**Michael J. Fiddelke** - Target Corporation - Executive VP & CFO

On the \$2 billion to \$3 billion, there's a piece of that, that shows up in 2023. But a large chunk of that is multiyear in nature. And you think about the apparel example that Mike shared, I think that's just a perfect example. That's a business that grew so fast over the last few years and our teams did an amazing job to protect the good guest experience as we grew.

But when we step back and look end-to-end across a business like apparel, we just see how much opportunity to simplify. Make things easier for the guests. Make things easier for our team. And changing some of those core processes won't happen overnight. That's why the multiyear nature is important. But we expect those benefits to be significant.

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**Brian C. Cornell** - Target Corporation - Chairman of the Board & CEO

Great. Let's go to this paddle right here.

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

Chris Horvers, JPMorgan. So my first question is you sit at these apex of different general merchandise categories that were major COVID winners. So as you peel away and look at the unit trends that you saw in the fourth quarter, are there signs of any stability, whether it's TVs or computing or decorative home or athleisure? Is there anything that has given you some encouragement to say like maybe we're getting to the bottom of the curve?

And then my second question is around the first quarter operating margin guide versus what's implied for the fiscal year. It doesn't look like the implied is maybe like 4.5 to 5 on the fiscal year. It's not much better than the midpoint of the first quarter but yet, they're bigger quarters. You're going to lap all these headwinds from the freight side, which should be coming down, the markdowns, the salvaging. So why isn't -- and presumably consumables inflation comes down so that relative performance improves, why wouldn't you see better operating margin performance over the year relative to 1Q?

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**Brian C. Cornell** - Target Corporation - Chairman of the Board & CEO

Christina, you want to unpack some of the trends we're seeing in discretionary categories?

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**A. Christina Hennington** - Target Corporation - Executive VP & Chief Growth Officer

Yes. The most consistent theme is where there's innovation, there's still relevance. And so consumers are finding them. Social media, of course, is a great way for consumers to become connected to new products and new ideas, and you'll be surprised things will spike quickly.

And sometimes we don't see them coming. In other times, we're well prepared. But I would tell you that there are pockets of those in every business. And so right now, we're planning the discretionary categories at an aggregate level more cautiously, but we're certainly leaning into market share opportunities where we see them. We believe that there's opportunity in the Home business, and we'll be launching more brands in the back half of this year, both on the national and owned brand side that have the potential to grow share in that category.

We're seeing it definitely in Apparel, where you get the right fashion moment and the right fashion trend. It doesn't matter that they bought a lot of performance wear over the last couple of years, they're still interested in buying new. And so that's been the most consistent correlation.

With that said, we're also introducing that level of newness and interest in categories like Food & Beverage and Essentials. Our favorite day brand that we've launched over the last couple of years, was a -- which is a sweets brand, has been -- has seen explosive growth over the last year or 2. And this is a place where we've taken the liberty to innovate in basic categories, whether it's cookies or ice cream and so forth, and the flavor

profiles, the way that they brought the items to market have really shown that the guests will engage across the board if we give them a reason to.

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**Brian C. Cornell** - *Target Corporation - Chairman of the Board & CEO*

Chris, if we go back to discretionary categories. You heard us talk today, Christina highlighted the fact that in 2022, despite some of the softening trends, we still generated \$55 billion of revenue in discretionary categories. One of the things I highlighted this morning during my CNBC interview is I go back to 2019. We've grown our discretionary portfolio by almost \$14 billion.

So we're going to move forward from a much bigger base and much more relevance in those categories. And to Christina's point, we know they are going to return to growth over time. It's going to be led by newness and innovation in the near term. But we're in a much different position going forward than we were pre-pandemic. And I think we have much more relevance and credibility in the space than ever before.

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**John J. Mulligan** - *Target Corporation - Executive VP & COO*

Yes. I think we're both at, what, 20 years or so at Target, Christina? We've seen ebbs and flows across the categories in our assortment over that time. And to us, the long-term winners will be the ones that build engagement in the moment now. That's why we're so focused on traffic. Apparel and Home will have their time in the sun again, and we'll be well positioned when they do.

On the first quarter versus the balance of the year, I think I'd go back to just some of the broader themes. I think the biggest variable, that's a tough one for any of us to predict right now, it's just what's the path of the consumer during the year. We planned the first quarter reflective and mindful of the discretionary trends that we saw in the fourth quarter. And we'll learn a lot, I think, together as we move through the year, and that will inform what the balance of the year plays out at. But we think an appropriately cautious approach based on the trends we've seen is the right place to start and we'll unpack it as the year progresses.

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**Brian C. Cornell** - *Target Corporation - Chairman of the Board & CEO*

I'm trying to scan through the room to see hands that have been up for a while that we haven't gotten to. Let's come back over here.

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**Karen Fiona Short** - *Crédit Suisse AG, Research Division - Research Analyst*

Karen Short from Credit Suisse. So a couple of questions I wanted to ask. We know what your tail -- or headwinds were for '22 in terms of dollars. You're at kind of the \$1 billion-plus mark. And obviously, we know what you're guiding to on operating profit dollars for this year.

But I guess the question that I would have is, it seems like maybe you've set a low bar. And so the real question is, if there's upside to the top line. Is that something you would choose to flow down to the bottom line? Or would you be more inclined to lean into continuing to, I guess, invest to maintain that kind of 5-plus percent operating margin for '23?

And then the second question I would have is just on the \$2 billion to \$3 billion, if you could just give a little bit more on the buckets of where those are coming from? And then it sounds like there's some capture in '23, but most of it is '24 and beyond?

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**Michael J. Fiddelke** - *Target Corporation - Executive VP & CFO*

Yes. It's a good question, Karen. And I guess I'd go back to just kind of philosophically how we think about the business. We're in the maximizing dollars business. And so we'd read and react through this year to make the right choices that we think maximize profit dollars both for 2023 and position us well for beyond.



I'd love nothing more than in the quarters to come and to say, gosh, some trends played out stronger. The consumer was stronger in the back half of the year than maybe we thought. And if that's the case, then we'd happily have that conversation and be thrilled to outperform.

But I think the reality is, as we sit at the start of the year, it's an uncertain environment. And we want to plan cautiously in that. And that isn't just kind of on paper caution, that's making sure that we're positioning the business right. It was important to start the year clean from an inventory perspective. We feel like we've accomplished that goal. And we'd like to lean appropriately cautiously in our inventory buys in the discretionary categories with a ton of flexibility to react if things would turn out better, but we think that's prudent for the volatility that we see right now.

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**Brian C. Cornell** - *Target Corporation - Chairman of the Board & CEO*

All right. Looks like we've got time for one more question. I see a paddle up in the back.

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**Peter Sloan Benedict** - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Great. Pressure is on here. Peter Benedict at Baird. I guess first question would be on gross margin, down a little more than 500 basis points since 2019. Assuming mix doesn't get any better the next couple of years, just curious, Michael, how you think about the recapture of a portion of that? Where are the opportunities there? What would you think? Again, without mix getting dramatically better.

And then my second question would just be, in the event that sales this year end up tougher than expected, your confidence in your ability to deliver still that \$1 billion of improvement in EBIT, how much flexibility are you thinking on that front?

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**Michael J. Fiddelke** - *Target Corporation - Executive VP & CFO*

Yes. Maybe I'll do those in reverse. The wide range of guidance that we gave today is reflective of the scenarios that we envision right now. And so we feel good about the line we've drawn in the sand with that guidance now and we'll get a lot smarter together as the year plays out.

When it comes to margin opportunities, we've talked about a lot of them already, but maybe one I would add to the list, just as a for example, is to link some of what Christina talked about with Target Circle and how valuable it is for us to be able to interact with our guests in a more individualized way. And that translates to good news on the top line, and we can make the right offer or the right message show up for the right guest at the right time.

It should also translate to efficiency on our markdowns as we get more efficient with personalized promotions. We've learned over time that a personalized promotion has a higher return than a mass promotion. And so Circle gives us the opportunity to do even more of that better in the years to come.

And so there's a lot of macro puts and takes, no doubt, as we unpack margin in the years to come, but there's also some important things that we're driving within the business that you know.

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**Brian C. Cornell** - *Target Corporation - Chairman of the Board & CEO*

Right. So with that, I want to thank all of you for joining us today. I know we'll see many of you throughout the year, and I hope to see all of you back here at the Time Center next year. So thanks for joining us. Get home safe.

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