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Darden Restaurants, Inc. (DRI)

Q4 2019 Earnings Call

CORPORATE PARTICIPANTS

Kevin Kalicak

Vice President, Investor Relations & Corporate Analysis, Darden Restaurants, Inc.

Eugene I. Lee

President, Chief Executive Officer & Director, Darden Restaurants, Inc.

Ricardo Cardenas

Senior Vice President & Chief Financial Officer, Darden Restaurants, Inc.

OTHER PARTICIPANTS

Michael Tamas

Analyst, Oppenheimer & Co., Inc.

David E. Tarantino

Analyst, Robert W. Baird & Co., Inc.

David Palmer

Analyst, Evercore ISI

Chris O'Cull

Analyst, Stifel, Nicolaus & Co., Inc.

Gregory R. Francfort

Analyst, Bank of America Merrill Lynch

John Glass

Analyst, Morgan Stanley & Co. LLC

Matthew J. DiFrisco

Analyst, Guggenheim Securities LLC

Jeffrey A. Bernstein

Analyst, Barclays Capital, Inc.

Andrew Strelzik

Analyst, BMO Capital Markets (United States)

Dennis Geiger

Analyst, UBS Securities LLC

John William Ivankoe

Analyst, JPMorgan Securities LLC

Sara Harkavy Senatore

Analyst, Sanford C. Bernstein & Co. LLC

Stephen Anderson

Analyst, Maxim Group LLC

Brian M. Vaccaro

Analyst, Raymond James & Associates, Inc.

MANAGEMENT DISCUSSION SECTION

Operator: Good morning. Welcome to the Darden Fiscal Year 2019 Fourth Quarter Earnings Call. Your lines have been placed on listen-only until the question-and-answer session. [Operator Instructions] This conference is being recorded. If you have any objections, you may disconnect at this time.

I will now turn the call over to Mr. Kevin Kalicak. Thank you. You may begin.

Kevin Kalicak

Vice President, Investor Relations & Corporate Analysis, Darden Restaurants, Inc.

Thank you, Jill. Good morning everyone and thank you for participating on today's call. Joining me on the call today are Gene Lee, Darden's CEO; and Rick Cardenas, CFO.

As a reminder, comments made during this call will include forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. These statements are subject to risks and uncertainties that could cause actual results to differ materially from our expectations and projections. Those risks are described in the company's press release which was distributed this morning and in its fillings with the Securities and Exchange Commission. We are simultaneously broadcasting a presentation during this call which is posted in the Investor Relations section of our website at darden.com. Today's discussion and presentation include certain non-GAAP measurements, and reconciliations of these measurements are included in the presentation. We plan to release fiscal 2020 first quarter earnings on September 19, before the market opens, followed by a conference call.

This morning, Gene will discuss our fiscal year performance and quarterly business highlights and Rick will provide more detail on our financial results from both the fourth quarter and the full year before providing our initial outlook for fiscal 2020. As a reminder, all references to the industry benchmark during today's call refer to estimated Knapp-Track excluding Darden. During our fiscal fourth quarter industry total sales growth was 0.7%, industry same-restaurant sales declined 0.3%, and industry same-restaurant guest counts decreased 2.4%. For the full fiscal year industry total sales growth was 1.6%, industry same-restaurant sales grew 0.7%, and industry same-restaurant guest counts decreased 1.2%.

Now, I will turn the call over to Gene.

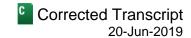
Eugene I. Lee

President, Chief Executive Officer & Director, Darden Restaurants, Inc.

Thank you, Kevin, and good morning, everyone. As you've seen from our press release this morning, the fourth quarter wrapped up a very strong fiscal 2019 for Darden. Total sales from continuing operations for the year were \$8.5 billion, an increase of 5.3%. Same-restaurant sales for the year increased 2.5%; and adjusted net earnings per share were \$5.82, an increase of 21% from last year.

I want to start this morning by briefly talking about the industry dynamics we saw during the fourth quarter and also share some thoughts on the consumer. As you know, the industry experienced sales volatility during the quarter. After a good March, April was a challenging month but the industry bounced back in May. A significant part of the volatility was due to the holiday shift which helped March but it hurt April. Our business followed the same pattern and I was pleased to see that our traffic gap to the industry expanded each month throughout the quarter. As we think about the consumer and look at the macro environment, the economy continues to be strong;

Q4 2019 Earnings Call



unemployment is at lowest levels in nearly 50 years; wages are growing at a healthy rate, outpacing inflation; and consumer confidence remains high.

Turning to our brand highlights for the quarter. Olive Garden had a good quarter which resulted in its 19th consecutive quarter of same-restaurant sales growth. Total sales grew 3.7% driven by same-restaurant sales growth of 2.4% and 1.3% growth from new restaurants. Same-restaurant guest counts declined 0.4%, but Olive Garden's gap to the industry expanded throughout the quarter even as they continue to reduce incentives. If you adjust for the lack of incentives, guest counts would've been positive during the quarter. Check average increased by 2.8% this quarter comprised of 1.6% pricing and 1.2% menu mix. The reduction in menu mix compared to the prior quarters was driven primarily by promotional offerings being similar to the prior year.

Olive Garden's results were driven by the team's focus on flawless execution, everyday value, and their off-premise business. During the quarter the restaurant team's focus on flawless execution helped maintain all-time high guest satisfaction ratings. A great example of this focus was on Mother's Day, the busiest day of the year at Olive Garden when they recorded the highest Mother's Day sales ever. Olive Garden continued to strengthen their everyday value platform throughout the quarter. They refreshed their 5 for \$5 value drink platform and increased awareness on everyday value through secondary TV advertising which highlighted their Lunch Duos starting at \$6.99, every day Early Dinner Duos starting at \$8.99, and Cucina Mia starting at \$9.99. Finally, Olive Garden's off-premise sales increased 9%, representing 15% of total sales. The team remains focused on improving ToGo capabilities and executing at a high level while driving continued growth in their catering business.

Olive Garden had an excellent year. They continue to gain share in casual dining market share as they grew total sales 5% to \$4.3 billion which outperformed the industry benchmark by 340 basis points, and grew traffic for the fourth year in a row. The business remained strong and the team is doing a great job of executing against the strategy to drive frequency among their most loyal guests while making the appropriate investments.

LongHorn Steakhouse had another strong quarter. Total sales grew 5.7% driven by 2.4% growth from new restaurants and same-restaurant sales growth of 3.3%, the 25th consecutive quarter same-restaurant sales growth. Same-restaurant guest counts grew 0.3%. The LongHorn team continues to successfully execute their long-term strategy of investing in the quality of the guest experience, simplifying operations to drive execution, and leveraging their unique culture to increase team member engagement. They remain focused on creating relevant promotions while leveraging their guest favorite core menu items. Focusing on core items ensures their operators are able to execute at a very high level. The LongHorn team also continued to do a great job of supporting these promotions by telling their quality story with multiple guest touch points.

Additionally, during the quarter LongHorn launched a new beverage program that brought their focus on quality, simplicity, and culture to life. The program is focused on strengthening their growing beverage sales, and initial guest feedback has been positive. Finally, the LongHorn team has been focused on ensuring their ToGo experience equals their in-restaurant experience for guests who choose this convenience. They're enhancing their capabilities and have a dedicated ToGo area in 40% of their restaurants. This ongoing focus has resulted in improvement in overall experience with high guest satisfaction scores for order accuracy and timeliness.

I'm very pleased with LongHorn's performance this year. They continued to take share of the casual dining market as they grew total sales 6.3% to \$1.8 billion which outperformed the industry benchmark by 470 basis points. These results reflect their commitment to execute their long-term strategy.

Q4 2019 Earnings Call



Cheddar's Scratch Kitchen total sales increased 0.6% in the fourth quarter driven by sales growth from new restaurants of 3.8% and offset by same-restaurant sales decline of 3.2%. The magnitude of this decline was driven by the former franchise restaurants which fell 6.1%. The original comping restaurants were down 1.5%. I was encouraged to see a sequential improvement in guest count trends for Cheddar's from Q3 to Q4.

At the beginning of the fiscal year the Cheddar's team established three strategic priorities – staff to win, master the tools, and standardize and simplify – with the goal of repairing fundamental elements of the business and shifting momentum. During the quarter they continue to make progress against these priorities. Overall staffing levels for both team member and managers are now on par with our standards; this better enables the Cheddar's team to focus on execution. And while turnover has improved, it is still significantly above the Darden norm. In addition, the restaurant teams continue to build acumen with our systems and tools; they improved the use of their guest count forecasting application which is critical to running efficient shifts.

Finally, the Cheddar's team made progress with standardization and simplification by deploying new culinary processes during the quarter. These improvements contributed to better execution, efficiency and productivity while enhancing speed of service. Fiscal 2019 was a challenging year for Cheddar's, one that was filled with significant change. However, the team made meaningful progress throughout the year that helped Cheddar's deliver double-digit profit growth this quarter. While I'm disappointed the work has yet to translate to top line sales growth, I am encouraged that we saw a 180-basis point improvement in guest count trends from the first half of the year to the second half of the year. These improvements indicate momentum is beginning to shift in the right direction. There's still a lot of work left to be done, but I'm confident in the plan the Cheddar's team has in place and their ability to execute it.

Fiscal 2019 was a great year for Darden. Our restaurant teams demonstrated their commitment to getting better every day as they executed our back to basics operating philosophy, and we continue to make meaningful progress in strengthening our core competitive advantages. I remain convinced that we have the right strategy in place and we are well-positioned to achieve our long-term value creation framework over time. On behalf of our board of directors and senior leadership team, I want to thank our 185,000 team members for all they do to make our company successful.

Now, I'll turn it over to Rick.

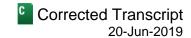
Ricardo Cardenas

Senior Vice President & Chief Financial Officer, Darden Restaurants, Inc.

Thank you, Gene, and good morning everyone. We're pleased with our fourth quarter performance. We grew total sales by 4.5% from the addition of 39 net-new restaurants and same-restaurant sales growth of 1.6%. Fourth quarter adjusted diluted net earnings per share from continuing operations was \$1.76, an increase of 26.6% from last year. This quarter we paid \$92 million in dividends and repurchased \$42 million in shares, returning a total of \$134 million of capital to our shareholders.

Looking at the P&L, restaurant-level EBITDA margin was flat versus last year and adjusted EBIT margins expanded 10 basis points to 11% this quarter. Food and beverage was flat to last year as pricing and cost savings offset inflation of just over 1% and unfavorable menu mix. Restaurant labor of 32.2% was unfavorable 10 basis points driven by mark-to-market, while the 120 basis points of unfavorability from continued wage inflation was offset by favorability from pricing leverage, incremental sales leverage from higher check mix, and productivity improvements. Both marketing and G&A were favorable 10 basis points driven by sales leverage. Depreciation and amortization was unfavorable 20 basis points as we continue to invest in new restaurant growth, remodels, and technology. Impairments were favorable 20 basis points as we lapped \$4.5 million of impairments last year

Q4 2019 Earnings Call



for restaurants that were earmarked for closing as their leases expired. Our effective tax rate for the quarter was 5.5%. This rate was approximately 400 basis points lower than we anticipated in March. Roughly half of this favorability was from a higher than anticipated benefit from stock option exercise and mark-to-market hedges. The remainder was the result of strategic tax projects that were completed in Q4.

Turning to our segment performance, all of our segments grew total sales and segment profit dollars again this quarter. Segment profit margin held flat at both Olive Garden and LongHorn, while the Fine Dining and other segments grew segment profit margins. Of particular note in the other segment as Gene mentioned, Cheddar's significantly grew segment profit this quarter even with negative same-restaurant sales as they focused on running more efficient food costs and labor.

Fiscal 2019 was another great year of performance as our brands continued to leverage Darden's scale and other competitive advantages. Our strong operating model generates significant cash flows, and this year was no exception. This year's strong top and bottom line performance drove approximately \$1.2 billion in EBITDA from continuing operations. We invested approximately \$450 million of capital in the business and returned over \$0.5 billion to shareholders consisting of \$371 million in dividends and \$208 million in share repurchases. In fact, since 2016 we've grown EBITDA 9% annually and returned over \$0.5 billion to shareholders each year in the form of dividends and share repurchases.

Before I share our outlook for fiscal 2020, I want to reiterate our long-term value creation framework. This frameworks calls for a 10% to 15% total shareholder return which is meant to be achieved over time, assuming a constant earnings multiple. Our actual total shareholder returns have well exceeded our long-term framework since its introduction in 2015. In fact, our annualized TSR over the three-year fiscal period ended May 26 was approximately 25%.

To achieve our long-term framework, we anticipate earnings after tax growth of 7% to 10% (15:00) which is made up of total sales growth of between 3% to 6% and EBIT margin expansion between 10 to 30 basis points. Additionally, we expect to return another 3% to 5% to shareholders in the form of a dividend payout ratio between 50% and 60% of our net income, and share repurchases between \$150 million and \$250 million.

As I mentioned on last quarter's call, fiscal 2020 includes two unique items: first, it's a 53-week year and we anticipate a positive impact on diluted net earnings per share from continuing operations of roughly \$0.15; second, in the first quarter of fiscal 2020, we are implementing ASC 842, the new accounting standard for leases. We currently estimate this will negatively impact EPS by approximately \$0.05. Roughly three-quarters of this impact is in interest, while the rest impacts EBIT.

Now turning to our full outlook for fiscal 2020. We expect total sales growth of 5.3% to 6.3%, driven by approximately 2% from the addition of the 53rd week; same-restaurant sales growth of 1% to 2%, and approximately 44 net new restaurants; capital spending between \$450 million and \$500 million; total inflation of approximately 2.5%, with commodities inflation of 1% to 2% and total labor inflation of 3.5% to 4.5%; and annual effective tax rate of 10% to 11%, and approximately 124 million diluted average shares outstanding for the year. All resulting in diluted net earnings per share between \$6.30 and \$6.45.

This morning, we also announced that our board approved a 17% increase to our regular quarterly dividend to \$0.88 per share, implying an annual dividend of \$3.52, resulting in a yield of 3% based on yesterday's closing share price.

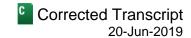
And with that, we'll take your questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question will be from Brian Bittner with Oppenheimer & Co. Sir, your line is open. Michael Tamas Analyst, Oppenheimer & Co., Inc. Great. Thanks. This is actually Mike Tamas on for Brian. You guys started out talking about a pretty healthy consumer environment. So, when you think about driving sales in 2020, is the playbook the same, is there anything you think you need to do differently, whether you're looking at the competitive environment or - and how do you think about 2020 sales drivers versus, say, the last 12 months which is really healthy? Thanks. Eugene I. Lee President, Chief Executive Officer & Director, Darden Restaurants, Inc. I think we stay focused on our back-to-basics philosophy. I think it's clearly more important than ever that we continue to ensure that our restaurants are staffed with the appropriate team members and that we're creating great dining experiences. We think there's still opportunity with throughput, especially on weekends and these high-demand days. And we're continuing to focus on how do we simplify our operations so that our teams can execute at a higher level. We're going to continue to win this at the [ph] nine square feet. (18:40) We've got to do a better job than our competitors do, taking care of our guests and providing offerings that our guests are excited about. So, I'd sum that up by saying our playbook's not changing; we're focused on the same exact things. Michael Tamas Analyst, Oppenheimer & Co., Inc. Got you. Thanks. And then just on the cost side of things, your total cost basket is up a little bit more in 2020 versus 2019. So, is there anything you have to do a little differently there, is there a little bit more productivity you need to kind of squeeze out of the [ph] mall (19:07), or how do you think about that? Thanks. Eugene I. Lee President, Chief Executive Officer & Director, Darden Restaurants, Inc. Yeah. We are working on productivity every year. We don't anticipate squeezing out a lot more than we did last year. We still anticipate productivity enhancements. But we also have a great supply chain team that will continue to look for cost savings to help offset any incremental inflation. Michael Tamas Analyst, Oppenheimer & Co., Inc. Thank you. Operator: Thank you for question, Mr. Bittner (sic) [Tamas] (19:32). Our next question comes from David Tarantino with Baird. Your line is open, sir. David E. Tarantino

Analyst, Robert W. Baird & Co., Inc.

Q4 2019 Earnings Call



Hi. Good morning. Gene, just a question about the industry environment. I appreciate your opening remarks. But if I look at the last three or four months, it does look like traffic in the industry has softened relative to what we were running, I guess, the prior 12 months. So wondering if you have some thoughts on why we're seeing that softening trend even when you're kind of normalize out for the calendar shift.

And then as you think about that trend, do you think you need to sort of normalize the value promotion or maybe tick back up the value promotion after maybe pulling back on some of the offers over the last 12 months or 24 months? Thanks.

Eugene I. Lee

President, Chief Executive Officer & Director, Darden Restaurants, Inc.

David, good morning. We've been trying to tease out the change in traffic trend. I'll pivot just here for one second to say what we're really pleased about is the industry traffic has softened a little bit, our gap has increased, and that's been really reassuring. We haven't been able to point to any particular thing that's causing the traffic softness in the industry, and we've tried. We've tried it from different angles.

Overall, I think our thought is that the consumers still in a really good place, and we don't see that changing here in the near-term. Obviously, we're living in a more volatile environment. I will say one of the things that we do see is day-to-day, week-to-week, there's a little bit more volatility than there was – there had been. And again, hard for us to try to figure out what's driving that.

As far as value, I think that we'll continue to look for ways to add value to the consumer proposition. I think as we think about incentives right now, we believe that we're still in the mode of withdrawing incentives based on the environment. I'd rather continue to find ways to invest in what we call everyday value in the businesses. But there's no doubt, we've taken a lot of currency out of the marketplace, and we do have that available to put back in if we think that's the right thing to do.

David E. Tarantino

Analyst, Robert W. Baird & Co., Inc.

And, Gene, maybe a follow-up on that last comment. What would you need to see to add back some of those incentives or get more aggressive on the value side?

Eugene I. Lee

President, Chief Executive Officer & Director, Darden Restaurants, Inc.

Well, I think, if our traffic started to go the other way against the industry, if the gap started to shrink, and I think then we have to consider what's going on with the business model. I think one of the things that we focus on is protecting our business model and using our scale, and not to make short-term decisions that may drive a few extra guests here and there but really aren't that profitable. So, I think as long as our gap to the industry is healthy from a traffic standpoint, we'll continue to be very cautious with that.

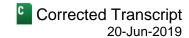
David E. Tarantino

Analyst, Robert W. Baird & Co., Inc.

Make sense. Thank you very much.

Operator: Thank you for your question, Mr. Tarantino. Our next question comes from David Palmer with Evercore ISI. Your line is open, sir.

Q4 2019 Earnings Call



David Palmer

Analyst, Evercore ISI

Thanks. Good morning. A question on just that polished casual dining side, it does look like that's a little tougher than it has been in that segment. Wondering if there is a reason or insight there, tax season, stock markets might impact that segment, and we're also regionally bigger on the West Coast. And then separately on LongHorn, is that brand picking up steam or was there in a way that feels like in the medium-term that [indiscernible] (23:37) there certain reasons within that guarter for that to happen? Thank you.

Eugene I. Lee

President, Chief Executive Officer & Director, Darden Restaurants, Inc.

Hey, David. Great question on polished. I've got a - I think, I'll sum that up by saying polished casual will operate in some the best retail trade areas across the country. And I believe there is more good competition, smaller brands that are really I know good businesses that are expanding in those trade areas putting more pressure on our polished casual brands.

And I'll use, I think, a very good example. I mean, if you're going to grow [ph] True Foods, (24:17) where are you going to put a [ph] True Foods (24:20) today? You're going to put it right on top of a Seasons 52. And there are other brewery brands that are where are they going to put their businesses, they're going to put them right on top of a Yard House. And so, those brands operate in very good trade areas, and we're experiencing a little bit more competition there. So I think you have – you asked a good question, but I think that's the insight there.

As far as LongHorn goes, we've been making, I think, since – when Todd Burrowes came back under his leadership we've been making great investments in LongHorn. And I think that there have been multiple-year investments, and I think we're gaining a lot of momentum in that business. We've increased the size of the steaks, we've simplified the operation, we've simplified the promotional constructs, and our retention is incredibly high; and we are executing on a really high-level. So I think there's a lot of good momentum in that business.

And last thought on LongHorn is, we had a pretty good growth curve there in, really, in the mid – between 2010 and 2015. We broke into a lot of new territories. And those new territories are really starting to mature nicely, and we're getting good growth from them. Going in and being the fourth or fifth steakhouse in the marketplace, it's really tough to break in and get into the consumer routines. And over time, we know that LongHorn will build loyalty in those years in their 3- to 10-year cycle. So, there's a lot of momentum in that piece of the business also.

David Palmer

Analyst, Evercore ISI

Thank you.

Operator: Thank you for your question, Mr. Palmer. Our next question comes from Chris O'Cull with Stifel. Your line is open.

Chris O'Cull

Analyst, Stifel, Nicolaus & Co., Inc.

Thanks. Good morning, guys. Gene, several of the bar and grill and midscale casual dining chains have been pretty aggressive with new promotional platforms. And while Olive Garden clearly has a scale to compete, do some of the other smaller brands like Cheddar's and Yard House, do they need to make any adjustments to their marketing strategy?

Q4 2019 Earnings Call



Eugene I. Lee

President, Chief Executive Officer & Director, Darden Restaurants, Inc.

Chris, I think that they've got to always re-examine where they are from a value standpoint. I would say that Cheddar's is the value leader. Maybe there is some opportunity as we move forward to highlight that value differently and to bring that to life. There's no doubt, and I've said that the last couple of calls, that the large casual dining brands are being much – are much more effective and disciplined today, and advertising very effectively and the share of voice is up. That's making it a little bit more difficult for Cheddar's to compete effectively, and we may have to think about how we go to market to highlight that great value that we have. But your insight is relevant, and it's a challenge that we face with the Cheddar's brand.

Chris O'Cull Analyst, Stifel, Nicolaus & Co., Inc.	Q
Is there any plans to test or introduce anything in coming quarters?	
Eugene I. Lee President, Chief Executive Officer & Director, Darden Restaurants, Inc.	Α
Yes, but I'm not going to talk about them.	
Chris O'Cull Analyst, Stifel, Nicolaus & Co., Inc.	Q
Fair enough. Thanks.	
Operator: Thank you for your question Mr. O'Cull. Our next question is from America Merrill Lynch. Your line is open, sir.	om Gregory Francfort with Bank of
Gregory R. Francfort	\cap

Hey. I just had two quick questions. The first one is just a follow-up to David's question on polished casual. Is there any difference in terms of the store growth capacity as it's happening at polished casual versus maybe casual dining more broadly? Because my understanding was casual dining store growth might be slowing a little bit.

And a question just for Rick, just on the cash balance and we're at the end of the quarter, I think the last time you ran a cash balance [ph] poster (28:04) this high, you made a pretty big acquisition. Is there reason why maybe you're not deploying that cash for repurchases? And as you think about acquisitions, how much does Cheddar's performance and the need to turn that impact your thoughts on future acquisitions? Thank you.

Eugene I. Lee
President, Chief Executive Officer & Director, Darden Restaurants, Inc.

I'll go first. On the polished growth, I think that it's an attractive space. We have a lot of entrepreneurs out there that over the last decade have created some pretty good concepts that are starting to get to – getting past that 10-unit area and starting to grow. It's obviously an attractive marketplace, but it's also relatively small. It just happens when we – on our smaller polished brands, when we have increased competition, it has a bigger effect on the overall top line number.

Analyst, Bank of America Merrill Lynch

Q4 2019 Earnings Call



What we do believe is that we can [ph] flight off (29:05) that initial competition over 12 to 18 months, and our restaurants will get back to the sales levels they were prior to the competition coming in. So it's just something that you have to – I think you have to continue to operate really well and you don't make an adjustment in the short-term for that increased competition; you just go back to winning the [ph] nine square feet (29:29) and your business will get back to growth.

Ricardo Cardenas

Senior Vice President & Chief Financial Officer, Darden Restaurants, Inc.



And as it relates to our cash balance, even though we have significantly more cash than we had last year, our team is still focused and doing the things every day to continue to increase that cash balance. And one thing that we did in the fourth quarter was we significantly improved our working capital position, and we also did a few more sale leasebacks. So that helped increase our cash balance. And I talked to the team's ability to continue to find the best use of our cash and actually take as much cash in as we possibly can even though we have some cash.

As it relates to what we're going to do with that, we continue to speak to our board to determine what the best use of that cash is, whether it's through share buybacks or dividends. And as you heard earlier, we just increased our dividend by 17%, and we will find the right times to either buy back shares or acquisitions if they come to play. It has nothing to do with Cheddar's, whether we're doing an acquisition right now or not; it just has to do with making sure that we have the right brands, et cetera, to target.

Gregory R. Francfort

Analyst, Bank of America Merrill Lynch



Thank you.

Operator: Thank you for your question Mr. Francfort. Our next question is from John Glass with Morgan Stanley. Your line is open, sir.

John Glass

Analyst, Morgan Stanley & Co. LLC



Thanks very much. I know Darden's position on delivery has been clear but, Gene, do you see either one that delivery is helping the overall industry in any way? It may not show up in traffic, but maybe it shows up in check for example. And, two, do you think by not participating in delivery at this point that in any ways put you at a traffic or total sales disadvantage?

Eugene I. Lee

President, Chief Executive Officer & Director, Darden Restaurants, Inc.



I'll start with the second part of that. I don't believe it's put us at a disadvantage at all. I really like the way our offpremise business continues to grow. I think we continue to remove friction from the process, and we continue to offer great value without having to have any destruction to our overall margins.

And so, I like where we're at. I don't think we're missing out on anything. I think this is still an immature business. There's still lots to learn. There's a lot of discussion around whether it's incremental, it's non-incremental. Where I want us to focus and I want our teams to focus on is creating a compelling in-restaurant experience that people want to come and visit.

Q4 2019 Earnings Call



I think when you do that, that helps create the demand for the off-premise visit. And we know convenience will continue to be important to the consumer, but our focus right now is to create a compelling in-restaurant experience that drives then a compelling off-premise experience in which the consumer still wants to come and pick – will still come and pick-up because the value and the quality of the offering is so strong.

John Glass

Analyst, Morgan Stanley & Co. LLC

And just as a follow-up – if I missed it, I'm sorry – what was the Olive Garden off-premise business this quarter and how much it did grow? And then just to the first part of my – first question was simply, do you see any evidence anyone is getting a real lift at delivery, or is this all talk and we haven't really seen industry sales in fact benefit from this in total?

Eugene I. Lee

President, Chief Executive Officer & Director, Darden Restaurants, Inc.

Yeah, sorry. I missed that part, John. I think that – I don't think I've seen any real growth from it. I'm seeing margin destruction, but that's my opinion. We've got test going on, and we're not – it's not – the results aren't compelling enough that we're running out and doing something with it. I think with that, I think it really indicates how we're feeling about it. Olive Garden ToGo was 9% for the quarter. Two-year stack of almost 18%. It's 14.5% of sales. I'm just – I'm really pleased with where we are with our off-premise business. We continue to enhance those capabilities, which is really important. And we continue to work with the adoption of digital because we think that's going to be a continued driver. And we've got some other investments that we're continuing to make – that we'll continue to make to remove some friction in the off-premise experience.

John Glass

Analyst, Morgan Stanley & Co. LLC

Great. Thank you so much.

Operator: Thank you for your question, Mr. Glass. Our next question's from Matthew DiFrisco with Guggenheim. Your line is open, sir.

Matthew J. DiFrisco

Analyst, Guggenheim Securities LLC

Thank you. I just had a follow-up and then a question. Specific to the Olive Garden and I guess what could be perceived as a slight shortfall versus what expectations were, and then LongHorn topping. Did the Olive Garden brand, was that the only one that saw basically less incentives and had somewhat of a drag in the quarter or did LongHorn experience some of that as well?

Eugene I. Lee

President, Chief Executive Officer & Director, Darden Restaurants, Inc.

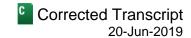
LongHorn didn't have the same drag as Olive Garden did. There was much more reduction in incentives in Olive Garden than LongHorn for the quarter.

Matthew J. DiFrisco

Analyst, Guggenheim Securities LLC

And where are we in that cycle of reductions? Are we going to expect that to continue into the first half of 2020, or are we starting to maybe now see more comparable year-over-year comparisons on incentives?

Q4 2019 Earnings Call



Eugene I. Lee

President, Chief Executive Officer & Director, Darden Restaurants, Inc.

I think we get to the middle of – beginning of the middle of the second quarter last year was when we started to start to really pull back.

Matthew J. DiFrisco

Analyst, Guggenheim Securities LLC

Okay.

Eugene I. Lee

President, Chief Executive Officer & Director, Darden Restaurants, Inc.

[indiscernible] (34:55) a little bit more time before we wrap that.

Matthew J. DiFrisco

Analyst, Guggenheim Securities LLC

And then my last question, you mentioned a lot about some of the competition coming in and where you would grow a store, the obvious place would be sort of where a Capital Grille already sits or some other of your brands. But as far as to real estate availability, say, for the next three to five years, what are you seeing out there for the potential for the Cheddar's brand and those brands that are lower – that are positioned best for the lower income consumer or the broader consumer base? A lot of has been said that there's not a lot of availability. Do you feel the same, or do you think the brand is something that can fit into more locations maybe than some other brands that have commented about tight locations?

Eugene I. Lee

President, Chief Executive Officer & Director, Darden Restaurants, Inc.

Well, I think, we have a lot of green space, right? So we're still relatively underpenetrated, so that gives you a lot more opportunity. It's obviously a lot easier for us to find sites for Cheddar's than it is for Olive Garden. I don't see availability being an issue for Cheddar's long-term growth, whereas Olive Garden now – I mean, everything that we do with Olive Garden, we have to really figure out what the cannibalization's going to be versus we don't have that much of an issue with Cheddar's. So, I think it all depends on what's your size, what's your penetration level. I don't see that as a burden as we move forward with Cheddar's.

Matthew J. DiFrisco

Analyst, Guggenheim Securities LLC

Thank you.

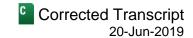
Operator: Thank you for your question, Mr. DiFrisco. Our next question is from Jeffrey Bernstein with Barclays. Your line is open.

Jeffrey A. Bernstein

Analyst, Barclays Capital, Inc.

Great. Thank you very much. Two questions. One, just on the fiscal 2020 guidance, I'm just wondering if there was anything in the fiscal fourth quarter just ended whether it'll be slower or more volatile comps, or maybe higher than expected costs; anything there that might have led to temper your initial fiscal 2020 guidance?

Q4 2019 Earnings Call



I know if you look at past years, seem like initial guidance was fairly conservative allowing for a beat and raise which, Gene, I know, that's a critical component is to guide conservatively. But, looking back to fiscal 2019, you beat comp by 75 basis points, should beat earnings growth by 700 percentage points. So, just wondering as you think about your initial guidance for 2020, how that was impacted by the most recent trends in the industry? And then I had one follow-up.

Ricardo Cardenas

Senior Vice President & Chief Financial Officer, Darden Restaurants, Inc.

Hey, Jeff. This is Rick. Yes. I'm assuming you're talking about our same-restaurant sales guidance of 1% to 2%. As Gene mentioned, we are seeing a little bit more volatility in the industry. And this is an annual guidance, so this is 12 months ahead of time. And so, we want to make sure that we're prudent. And being at the lower end of our 1% to 3% range makes sense. We also have seen a little bit of a slowdown in discretionary spending in this calendar year versus last calendar year. So, we feel like 1% to 2% is the right range at this time.

Jeffrey A. Bernstein

Analyst, Barclays Capital, Inc.

And from an earnings per share perspective, would you view that similarly in terms of a little bit more cautious to start the year?

Ricardo Cardenas

Senior Vice President & Chief Financial Officer, Darden Restaurants, Inc.

I wouldn't say it's a little bit more cautious to start the year than we've been in the past. We have a few things. One, it's our same-restaurant sales of 1% to 2% with a little bit more inflation that we've seen in the past. And also, a big difference in tax rate year-over-year will impact our EPS.

Jeffrey A. Bernstein

Analyst, Barclays Capital, Inc.

Got it. And my follow-up was just on the unit guidance for fiscal 2020. It seems like on a net basis, we're looking at roughly 2.5% growth. I'm just wondering, if you could give some color in terms of where Olive Garden and LongHorn fall into that, and confidence in Cheddar's maybe accelerating or is Cheddar's still in wait-and-see mode?

Ricardo Cardenas

Senior Vice President & Chief Financial Officer, Darden Restaurants, Inc.

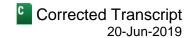
Yeah. First of all, in the broad picture, the total number of openings that we have this year will be very similar to last year. The difference is the openings will fall a little bit later in the fiscal year than they did this year, just because of construction and developers not necessarily meeting the time lines that they had originally. So, while our openings will be about the same, our timing will be a little bit different. The total percent from Olive Garden and LongHorn is about - a little bit over half of our total openings, which isn't that different than we've had this year. Cheddar's will have about the same case as last year.

Jeffrey A. Bernstein

Analyst, Barclays Capital, Inc.

Got you. Thank you.

Q4 2019 Earnings Call



Operator: Thank you for your question, Mr. Bernstein. Our next question is from Andrew Strelzik with BMO Capital Markets. Your line is open, sir.

Andrew Strelzik

Analyst, BMO Capital Markets (United States)

Hey, good morning. Two things for me. First, a number of the casual diners that have pulled back on promotional activity are actually performing from a same-store sales perspective among the best in the group. I'm just wondering, do you think the consumer sensitivity to discounting has maybe lessened a bit, or it's less disruptive that it has been in the past with more everyday value on menus across the group? That's first.

And second, the conversation on African swine fever has ticked up and I saw that you increased the commodity inflation relative to last year. How did that play into your thinking? How comfortable are you with that and how it may affect Darden? Thanks.

Eugene I. Lee

President, Chief Executive Officer & Director, Darden Restaurants, Inc.

Yeah. On the everyday value question and sensitivity promotions, I think there's been a lot of good work done in the industry over the last couple of years to put more everyday value in. And we've been saying for a while, the consumer didn't want to be told what they had to do, what they had to buy to get that value. And I think a lot of people have rotated to more everyday value. And to be able to do that means that you have to be less promotional when you make that strategic choice. So, I think there's not much more for me to add there other than I believe we kind of – we led the way with everyday value, others have followed. I think it's the right thing to do and it tones down the promotional activity.

Rick, will talk about the other question.

Ricardo Cardenas

Senior Vice President & Chief Financial Officer, Darden Restaurants, Inc.

As it relates to African swine flu, a couple of things. One is, pork represents approximately 2% of our total buy. So it's really a small impact. And it has very, very small impact on our guide. It's going to take 18 to 36 months for this to work itself out. We're currently seeing a huge increase in pricing, but we expect to see some more of that in the back half of the year, and that's already contemplated in our inflation numbers.

Andrew Strelzik

Analyst, BMO Capital Markets (United States)

Great. Thank you very much.

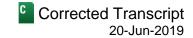
Operator: Thank you for your question Mr. Strelzik. Our next question is from Dennis Geiger with UBS. Your line is open.

Dennis Geiger

Analyst, UBS Securities LLC

Thank you. Gene, I wanted to ask a bit about the strength of operational execution in Olive Garden, which you often identify as the biggest driver of the brand's success and probably the largest sales driver. So just wondering if you could talk more about op execution in the quarter, if it remained a strong as what you've seen in recent quarters? And then I guess just more importantly, if you could frame the run rate from here for operations and

Q4 2019 Earnings Call



throughput specifically, to be a continued driver of outperformance as we look ahead through the balance of the year? Thanks.

Eugene I. Lee

President, Chief Executive Officer & Director, Darden Restaurants, Inc.

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Yeah. I think the team continues to make progress on improving operational execution. There's always a pockets in a system the size of Olive Garden that has opportunities. There's always opportunities day-to-day, week-to-week to improve your overall execution. When you think about the size of Olive Garden and the number of service that we have on each and every day, there is always – we always break down a little bit. So every day that we break down a little bit less, more guests have a better experience. The key to this long-term are continued simplification, and I believe that management and the operating team inside Olive Garden is really focused on taking the simplification to the next level. And that could drive even further improvement in overall execution for the next couple of years.

Throughput will always continue to be an opportunity. We were very effective from an advertising standpoint. A lot of our advertising drives people on Friday and Saturday nights. And we have long waits in our restaurants, and that's – we talk a lot about convenience, and that's not very convenient. And consequently, we've got to get better at making that experience more convenient for the consumer and we've got to get – we have to get more people and guests to our restaurants each hour and shorten up those dining experiences. So we're going to continue to focus on this, and we think it's a big upside.

Dennis Geiger

Analyst, UBS Securities LLC

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Great. And then just, if I could, just recognizing you've given a lot of the key guidance pieces which is great. Can you also just summarize your expectations thinking about EBIT margins for the year, maybe relative to the long-term framework? If there's anything else you could add there specific to that item. Thanks.

Ricardo Cardenas

Senior Vice President & Chief Financial Officer, Darden Restaurants, Inc.

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Yeah, Dennis. This is Rick. Our EBIT margin will be within our long-term framework. And our long-term framework, as a reminder, is 10 to 30 basis points.

Dennis Geiger

Analyst, UBS Securities LLC

Thank you.

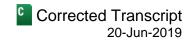
Operator: Thank you for your question, Mr. Geiger. Our next question is from John Ivankoe with JPMorgan. Your line is open.

John William Ivankoe

Analyst, JPMorgan Securities LLC

Hi. Thank you. I wanted to go back to off-premise for Olive Garden. Obviously, at 15% of sales it's actually getting pretty big on a per-store basis. Gene, you mentioned enhancing capability; I think that was around off-premise. How big do you think that can be? On a per-store basis how much would you want it to be, obviously considering that much of that business is going to come when you're already at the busiest on a Friday or a Saturday night?

Q4 2019 Earnings Call



Eugene I. Lee

President, Chief Executive Officer & Director, Darden Restaurants, Inc.

Yeah. I think that's always going to depend on consumer demand. I think improving our capabilities is going to be an important part of growing this. We just opened a new prototype in Orlando that has a full, dedicated off-premise area where we're learning a lot from that. We think that that has tremendous upside for our higher-volume off-premise restaurants. We have restaurants now doing well over \$1 million off-premise. A lot of this business comes in and is out the door before 11:30. And again, a lot of the catering that we're starting to do now is really off – it's pre the big meal period, and so that's really helpful.

So we've got multiple projects going on today to improve our capabilities. And then we think there's some attachment opportunities. Can we attach additional sales to the normal off-premise experience? An example. If we start building these take-out spaces, can we get some more beverage sale? Can we get other attachment? We're still in the infancy of thinking about that, but we think it's a fairly big idea which could grow that overall percentage over time. I think the way to summarize this is that we see tremendous opportunity in this space without sacrificing what we're really here to do which is create a great in-restaurant experience.

John William Ivankoe

Analyst, JPMorgan Securities LLC

And how big of a capital project would you wanted these dedicated take-out spaces be in existing restaurants?

Eugene I. Lee

President, Chief Executive Officer & Director, Darden Restaurants, Inc.

John, it's too early to really talk about that. But we've got to figure out in the different prototypes we have where would we add it. It has to be added in a specific place where you can staff it in your downtimes without adding a lot of labor. You want proximity to the kitchen. You got to have the right heating and holding areas. And so I don't want to put a price tag on it right yet. We're still too early in that process.

John William Ivankoe

Analyst, JPMorgan Securities LLC

Helpful. Thank you.

Operator: And thank you for your question, Mr. Ivankoe. Our next question is from Sarah Senatore with Bernstein. Your line is open, ma'am.

Sara Harkavy Senatore

Analyst, Sanford C. Bernstein & Co. LLC

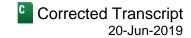
Thank you. I have a follow-up actually on Olive Garden and then a question on Cheddar's. On Olive Garden, I know you have said that in the past you were trying to reduce mix, and also obviously you talked about pulling some promotional activity. But I guess margins seem fairly flat versus last year, so I was just trying to understand a little bit about how to think about the trade-off between comp and margin or traffic and mix? However you think about the complexion of the comp and how that flows through the margins? And then I have a question on Cheddar's, too.

Eugene I. Lee

President, Chief Executive Officer & Director, Darden Restaurants, Inc.

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Q4 2019 Earnings Call



I think the margin impact in the quarter had a lot more to do with the investment we made with the Chicken Alfredo with the 50% more chicken which ticked up our cost of sales, and then we had a promotional construct that was pretty similar to last year. At the same time, we didn't have the trade-up opportunity that was driving a lot of mix. I mean, at the end of the day, when you look at that Olive Garden margin there's no one out there in the space that has those types of margins, and we're going to continue to invest in value which may limit the upward mobility of that. We don't expect margins to contract, but I want to make sure that we're investing properly into that business.

Sara Harkavy Senatore

Analyst, Sanford C. Bernstein & Co. LLC

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Okay. Thank you. And then on Cheddar's, a couple of comments just about – you talked about maybe not having as much scale. You also talked about how the franchise businesses continue to be a much bigger drag certainly than the – or the formerly franchise than the rest. I guess as you think about that system going forward, one is I guess to me Darden's scale was a big part of where the value creation could be with respect to Cheddar's. So I'm just trying to understand how you think about scale in the context of a brand that's smaller but as a part of a very large system like Darden. And then also, would you ever contemplate doing something more drastic with the former franchise restaurants? I assume that you're still covering their cost of capital. But at some point, does it ever make sense to close them or to think about them differently?

Eugene I. Lee

President, Chief Executive Officer & Director, Darden Restaurants, Inc.

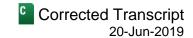


No. I mean, I'll start with the latter part of that question. These restaurants that are dragging the comp down are still extremely busy. I mean, most of them are very high-volume restaurants that are leaking back down to more of the system average, so these are still great restaurants on average. They still produce good returns. They've been through the most change, and that I think has created the most – this have been the most disrupted restaurants, and I think that's why we're seeing a lot of the same-restaurant sales decline come from those restaurants. The big disruption has been total management change, total system change. Everything that they do day-in and day-out has just changed operationally, and they've had some tough times adjusting. But overall, these are great restaurants and great territories so there's no drastic we're going to close these things.

I think when you look at it, and Rick alluded to it and I talked about it, we made more money in Cheddar's this quarter than we did last quarter. I think one of the things I'm really excited about in Cheddar's is when we literally look at it and dissect it, our guest counts improved Q3 to Q4 against the industry 160 basis points. As the industry weakened, Cheddar's guest count actually improved so, I mean, we're making progress. One more thing on Cheddar's that I didn't talk about in my prepared remarks but I think it's important to recognize is that we've been transforming these kitchens in the last year. We've done approximately 100 of them; we did 34 in the fourth quarter. This is a very disruptive process, and the majority of the transformations this quarter were done in the formerly franchise restaurants. This transformation allows us to really improve the efficiency in labor, improve the speed of service with the food coming out of the kitchen. These were big, big moves. This is behind us. And we're really excited about this and we think that this is going to have a big impact. One of the things that we do know is that there is a significant sales decline after we do transformation as the team struggle with this new operating procedure, but that works its way out.

As far as scale goes, I think my reference to scale was more about just the overall size of the brand and the future growth opportunities. Today, Cheddar's is definitely benefiting from our scale. It's plugged into our supply chain. It's been a huge benefit for them. It's allowed us to really continue to focus on value for the consumer, and so I think scale is working for them on that side. They're going to benefit from our data scale over time. And most

Q4 2019 Earnings Call



importantly, I think the thing that I continue to focus on is can we get these human resource metrics closer to our Darden norms? I think when that happens, that's where we're going to see some really great growth.

Sara Harkavy Senatore

Analyst, Sanford C. Bernstein & Co. LLC

Thank you.

Operator: Thank you for your question, Miss Senatore. Our last question is from Stephen Anderson with Maxim Group. Your line is open, sir.

Stephen Anderson

Analyst, Maxim Group LLC

Yes. Thank you. I wanted to ask about the rewards program you have in tests; it's about 130 restaurants or so. I wanted to ask what progress you've seen, what you've learned from that experience, and perhaps any plans to expand that program? Thank you.

Eugene I. Lee

President, Chief Executive Officer & Director, Darden Restaurants, Inc.

We continue to have the rewards program in test. We continue to analyze what's happening there. There's some really positive in that program. There's some challenges with that program. We're going to continue to observe this and figure out whether we can drive greater loyalty with it. If not, we'll dissolve it. And at this point in time we have no plans to roll it out, we have no plans to dissolve it, and we'll continue to observe the consumer behavior.

Stephen Anderson

Analyst, Maxim Group LLC

All right. Thank you.

Operator: Thank you for your question, Mr. Anderson. We do have a question from Brian Vaccaro with Raymond James. Your line is open, sir.

Brian M. Vaccaro

Analyst, Raymond James & Associates, Inc.

Thanks. I just wanted to – I was hoping to circle back on third party delivery. Gene, we've seen some concepts that have been hesitant historically sort of recently announce they're launching delivery. And it seems more broadly that the economics for restaurants, and maybe particularly those large chains, could be improving. Would you agree with that? And I heard your earlier comments, but are we getting closer to the point where it makes sense to pursue that opportunity with the existing off-premise growth moderating here? Thank you.

Eugene I. Lee

President, Chief Executive Officer & Director, Darden Restaurants, Inc.

Well, I think that the economics or the burden of third party delivery is being shifted to the company to the consumer. What I'm seeing is brands moving that burden away from themselves and onto the consumer. And at this point I'm just a little uncomfortable with that, what percentage is the consumer long-term willing to pay their overall check to have that convenience. And that has to be proved out to me over time if that's something that we want to to. We're still in a value proposition. And I'm just not sure. We're watching what everybody is doing.

Q4 2019 Earnings Call



We continue to believe, especially in Olive Garden, that it's much better for us to focus on the catering and delivery part of this. We've just changed how we think about that. The dollar size of the order now has moved from \$100 to \$75 and we've moved from 24-hour notice to 5:00 the day before. We think that that is a strong move and we are very interested in delivering ourselves to people who want to have a food experience delivered over \$75. And again, the average order of that activity for us is well over \$300. It's highly rated from a satisfaction standpoint event, and we want to focus on that more so than trying to move a \$15 entrée. And so again, we're watching what's happening. We don't think that the economic burden has changed that much; we think it's just been shifted from the restaurant to the consumer.

Brian M. Vaccaro

Analyst, Raymond James & Associates, Inc.

Yeah. Understood, that makes sense. And just back to the changes you made on your existing off-premise, the pricing, and the order times. When was that put in place? Was that literally like this quarter or was that partially through fiscal 4Q?

Eugene I. Lee

President, Chief Executive Officer & Director, Darden Restaurants, Inc.

It's just being put in place now.

Brian M. Vaccaro

Analyst, Raymond James & Associates, Inc.

Okay. Very helpful. Thank you.

Operator: Thank you for your question Mr. Vaccaro. I will now turn the conference back over to Kevin Kalicak for closing remarks.

Kevin Kalicak

Vice President, Investor Relations & Corporate Analysis, Darden Restaurants, Inc.

All right. Thanks, Jill. With that, that concludes our call. I want to remind everybody that we plan to release first quarter results on Thursday, September 19, before the market opens, with the conference call to follow. Thanks again for participating in today's call.

Operator: That does conclude today's conference call. We thank you all for participating. You may now disconnect and have a great rest of your day.



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