

Piper Jaffray Consumer Marketplace Conference

Company Participants

- Patrick J. Grismer, Chief Financial Officer & Executive Vice President

Other Participants

- Deb Schoneman, Managing Director, President, Piper Jaffray & Co
- Nicole Miller Regan, Analyst, Piper Jaffray & Co

Presentation

Deb Schoneman {BIO 16056418 <GO>}

Good morning everyone. I'm going get us kicked off here this morning. My name is Deb Schoneman, I'm President of Piper Jaffray. And I just want to welcome you all to the 39th year of our Legacy Consumer Conference. And each year, I feel like it kid, more and more special we've have an amazing group of senior analysts, who've been working together for 10 years. Who, I think keep finding new and creative ways to bringing this conference to you each year. Really I would say the foundation's are really thoughtful research, our analysts are bringing together really world class companies frequently and whether it's large or small, public or private and you really see that here today.

One of things that we're excited about, you notice that the name of this conference is titled consumer marketplace. We're really bringing together brands and products and services to you that you can actually consume. You're on the second floor through our marketplace. One of things we're excited about over the last few years, the number of participating companies in this conference has doubled and so we continue to see it expand and we're so appreciative of the opportunity that we are able to create this platform to allow companies and emerging industries really to tell their story.

Now, see from the schedule, there's a number of panels today and just a couple of items that I would highlight just to give you a quick preview. You're going to hear leading companies discuss the growing importance of really environmental, social and governance and incorporating that into your business models. You will hear about new technology shaping the way restaurants operate both from the front to the back of the house, and really an entire track that you're dedicated to global opportunities in the cannabis industry. So I just want to thank both the presenting companies as well as all of our investing clients for attending today. And I just want to wish you a great day both learning and exploring.

And with that, I will turn it over to Nicole Miller Regan. Thank you.

Nicole Miller Regan {BIO 5884270 <GO>}

Thank you for that introduction. So it's my pleasure to introduce Pat Grismer. He is the Executive Vice President and Chief Financial Officer of Starbucks. He joined the Company last year and he has a very accomplished financial background. It spans 25 years with many prominent restaurant leisure companies, such as Hyatt and Yum! Brands and Disney. Thanks, Pat, for coming.

Patrick J. Grismer {BIO 15965217 <GO>}

Thank you very much. Delighted to be here.

Nicole Miller Regan {BIO 5884270 <GO>}

So, how fun is it now to be at Starbucks, and what does the brand mean to you personally?

Patrick J. Grismer {BIO 15965217 <GO>}

Well, it's a tremendous thrill. We all know that Starbucks is a global iconic brand, a very special brand in the minds of consumers. And I've been a fan of the brand for many decades now. So to have the opportunity to be part of the leadership team that is charting the next leg of growth from one of the world's most admired brands is truly a privilege.

Nicole Miller Regan {BIO 5884270 <GO>}

Starbucks is very much a growth company. In the last call, you and Kevin very well outlined that Starbucks as a portfolio investment model. And this involves the variable approaches to company ownership, licensing and franchising in different territories. So how has Starbucks captured best practices for development pretty much in a way that you experienced at your other global companies in terms of expansion?

Patrick J. Grismer {BIO 15965217 <GO>}

Well, Starbucks has very much embraced the model of stimulating international development through partnerships, largely through the establishment of relationships with large well-capitalized licensors, who share our passion for the Starbucks plan. And what we found and this is consistent with my experience at other consumer-facing companies that have a global footprint is that local partners understand local consumers. And they can, in many ways, help to accelerate the pace of development for us in countries around the world. But at the same time, we also recognize the importance of attaining the ownership in countries that have a favorable profile economically for us.

So, that's one of the reasons why alongside the U.S., China is one of our lead growth markets for the long-term, because it's obviously a country with significant long-term

growth potential and the business that we've established there over the last 20 years having been built in China for China has a very favorable economic profile. We enjoyed strong profitability, strong returns on new unit investment and we feel very good about the position that we've established with Chinese consumers with a brand that has resonated quite strongly with all generations of consumers.

Nicole Miller Regan {BIO 5884270 <GO>}

I think that's a very relevant topic. Actually, it was around this time last year that we traveled to China to tour the stores in Shanghai. And I remember it was interesting to see many of those stores carefully combine the elements of the third place with a digital as a fourth place in a really balanced way. So how do you compare and contrast Starbucks update and modifying a more mature U.S. footprint, where you started with a third place and now you have to add this fourth place, whereas in China you can do it all at once?

Patrick J. Grismer {BIO 15965217 <GO>}

Terrific question. And so I'll start with what the two markets have in common. And what they have in common is the essence of the Starbucks brand, which is rooted in a very unique customer partner connection, we call our employees partners. And a point of differentiation -- a key point of differentiation for us at Starbucks is the quality of our partners in our stores and the connection that they establish with customers. We know that consumers all over the world are valuing increasingly experiences over products. So as we think about what we bring to market, of course, it starts with high-quality products that are highly differentiated and customizable, which is what consumers are looking for. But that is amplified by a very special customer partner connection, and that's what the two markets have in common.

But focusing on China and how it is different from the U.S. to your point, it is -- it has grown more rapidly, more recently. So when you look at our store base, a larger percentage are newer stores and at the same time we are taking what is a very special third-place experience and complementing that with this fourth-place experience, which is how we are able to expand our business through digital channels. And for us in China that has started with a very special partnership that we enjoy with Alibaba.

I mentioned previously, China business has been growing through partnerships and we have a very tight connection to Chinese consumers and partners who support our business in many different ways, and Alibaba is a very important partner to us. And so we collaborated with them to enhance our digital platform and then to launch delivery. We know that one of the important need states for consumers generally and this applies across the world is convenience. And certainly, Chinese consumers are looking for opportunities to engage with brands that can meet them when they have a particular need. So we know that delivery is an important occasion or need state for Chinese consumers, and Alibaba has proven to be a very effective partner to us in unlocking that and being able to provide that kind of fourth-place experience, as you mentioned.

In terms of how then marry that with a third place, the Chinese team was very thoughtful about how we designed the menu for delivery, knowing the consumers value, the quality of our products and the type of experience they get in our stores, we wanted to make sure that through this fourth-place experience, we were not in anyway diluting that. So the team thought through what we offered on the menu and there are certain products that don't travel well in delivery if the target is to deliver a beverage in 20 minutes or less, think about it. I know a macchiato or a cappuccino, something that has foam, it doesn't hold up well after 20 minutes. And so there were certain products that were removed from the delivery menu, so that we could, with confidence, enter into delivery knowing that our consumers would be having a comparable high-quality product and service experience whether in that fourth place or the third place.

Just to round out the question you asked in terms of how that compares to the U.S.? The U.S. is a more established business, but still rapidly growing. Even for a business of our scale in the U.S. fairly well penetrated with Starbucks, we have about 15,000 stores in the U.S. There is still open territory for us for development, so we are still growing even at that scale at a rate of 3% to 4% units per year. We are at the same time unlocking new opportunity to grow average unit volumes through a fourth-place experience, whether that's expanding the impact of our Starbucks Rewards loyalty program and also the advent of delivery.

Nicole Miller Regan {BIO 5884270 <GO>}

The work convenience really struck me, I think, that is an important way to think about the framework of what we're talking about. So how wide open is the growth opportunity for China? Because convenience can mean the digital aspect. It can also mean more stores. And so as a CFO, how would you like to see this accelerated development that's happening balanced against positive same-store sales as a metric in a perfect world? We know that we take dollars to bank and not percentages yet, we always come back to this question?

Patrick J. Grismer {BIO 15965217 <GO>}

Terrific question. As we think about what the China market opportunity represents in the long-term, particularly given the growth of the consuming class, we see significant potential we believe that we are well positioned to capitalize on that. And therefore, given the strength of our new unit returns and how our brand continues to resonate with Chinese consumers across all demographic categories, we are developing aggressively. We're encouraged by the results that we see as we open new units, not only in the existing, more heavily penetrated Tier 1 and Tier 2 cities, but in lower tier cities as well. The question then as to how we balance the opportunity to grow through units versus the importance of sustaining same-store sales growth that is fundamental to our ability to sustain high returns and good margins is one that we think about quite a bit.

And we believe and this is consistent with my experience at other companies, that in a high-growth environment like China, it is important to secure that first-mover advantage. And so as we think about the growth opportunity, we are looking to

enter many new cities to establish our position, to establish our presence, to build awareness that we know provides competitive advantage as the overall category grows. So one way to think about it is that in our aspiration to grow, to your point, total sales and total profits, about 80% of our growth equation is through new unit development, the other 20% through same-store sales and improved profitability of our existing store base.

So that, that does mean that as we grow at a more aggressive pace, there will be sales transfer or cannibalization. But we do that mindfully and intentionally and in a controlled fashion to ensure that we maintain good strong unit economics, which are fundamental to our ability to realize strong returns on the capital we're putting behind this growth.

Nicole Miller Regan {BIO 5884270 <GO>}

And that's a great way to frame it up. I think it really opened my eyes and I urge people, you have to be there to see it, because the Tier 1 city versus the Tier 2 and Tier 3 is something we're talking about last night, the white space. It's back, it's a completely open opportunity. So --

Patrick J. Grismer {BIO 15965217 <GO>}

So the one thing I would like to say is that, obviously, operating a business in China provides lots of opportunity, but there are challenges as well. It's the type of opportunity that we don't take lightly. We feel very privileged to be operating there and we feel very good about the relationships we've established with our partners, about 50,000 partners in China. We employ the suppliers in China who supply the goods and services that are fundamental to our ability to have such a large and growing retail operation and then the partnerships with Alibaba and others. And so, we feel very privileged. It's a type of business, where we remain a humble and balanced perspective on the opportunity and how we are positioned to capitalize on that.

Nicole Miller Regan {BIO 5884270 <GO>}

So if we switch gears a little bit and think globally about the umbrella of Starbucks, there's a lot of scales we had as a brand, really along global points of distribution. So I've always wondered when you think about channel activities, what's the sequence? Is it better to go in with a store and then retail, or retail and then a store? Because I would think the Nestle relationship really impacts that model?

Patrick J. Grismer {BIO 15965217 <GO>}

Well, we definitely think about Starbucks as a brand that plays well across the entire coffee category, the entire coffee addressable market. Well, yes, our heritage and our strength is in specialty retail, and that's where we have focused most of our resources. That is but one element of the total coffee category. So we are mindful of the away-from-home experience, single serve, whole bean roast ground and instant, including foodservice.

And so, our partnership with Nestle affords us the opportunity to penetrate those other categories within coffee leveraging the strength of our brand and credibility that we have in coffee, generally high-quality coffee. What we have found is that, leveraging that relationship will accelerate our penetration across more than 100 countries, but preference or priority given to those countries where we have an established presence with specialty retail.

So there is a natural sequence. As we've built the relationship with Nestle, we have given preference or priority to those markets where we have a good strong specialty retail presence that has created a lot of brand awareness and brand preference and then we can capitalize on that as we come behind that with strong offerings and collaboration with Nestle to ensure that we are building share in categories like EPG and foodservice.

Nicole Miller Regan {BIO 5884270 <GO>}

I have not heard it prioritized that way that sequencing is very helpful. So let's also think about Starbucks and the benefits of scale in digital development. A couple of quick questions in terms of digital, I'll just fire away. So how should digital tactics best align to support guests new trial and frequency?

Patrick J. Grismer {BIO 15965217 <GO>}

Well, certainly, we see digital as a significant opportunity for us to increase customer engagement, given that consumers increasingly are moving to digital channels to engage with brands. And so from a tactical perspective, our focus has been on removing or reducing those points of friction in digital engagement, whether making it easier for customers to sign up, easier to place an order by removing the steps.

I think, last year, we've reduced from seven to three steps to place an order and then continuing to enhance our customer analytics capabilities and our machine learning capabilities. So that as consumers are engaging with us on the mobile apps to place orders, they can see recommendations that are very relevant to them. They can see the history of their orders that facilitates placing future orders. So those are some of the tactical ways we're looking to improve the digital experience in ways that drive even higher levels of guest engagement, both in terms of frequency and spend.

Nicole Miller Regan {BIO 5884270 <GO>}

I imagine, you've already touched on Alibaba in China in that regard, but there must be some best practices that you're bringing back, is this the case?

Patrick J. Grismer {BIO 15965217 <GO>}

There are and I'm delighted to say, actually that as both China and the U.S. are focused on unlocking the opportunity in digital. There's no house sharing between the two. So it's not one way from China to the U.S. or U.S. to China, but the teams are communicating and collaborating to adopt the best practices. So an example would

be in the case of U.S. innovation around the early work we're doing with delivery, significant development and innovation around packaging, how to protect the quality of the product, how to preserve the integrity, so that there is 'there's tamper evident packaging, which is important to consumers. Even lids that reduce the amount of spill through delivery, there has been knowledge transfer from the U.S. to China.

And in the case of China, they have done substantial innovation in partnership with Alibaba around what new retail formats may look like. So I was in China recently and had the opportunity to tour what is called the Hema Supermarket and the Ele.me, which is a division at Alibaba delivery operation there that involves a hidden kitchen, because of a consumers placing an order for delivery, it doesn't really matter where that is prepared.

What the consumer cares about is that, it is of high-quality and that it's delivered in a timely fashion. And so they're experimenting with hidden kitchen type operations in China, and we're learning from their experience to understand how we might bring a similar model to life in the U. S., particularly in large metro markets like New York.

Nicole Miller Regan {BIO 5884270 <GO>}

That's very fascinating. In March, I was looking to Annual Meeting and you discussed the plan to modernize Starbucks and the part of that was going to start here in New York with a U.S.-based delivery approach, how is it going?

Patrick J. Grismer {BIO 15965217 <GO>}

So we launched delivery in partnership with Uber Eats in fall of last year through a pilot program in Miami. Since then as of the end of our second fiscal quarter, we are 1,600 stores across seven cities here in the U.S. So we are gaining experience as we go. In the case of New York, specifically, on top of the delivery opportunity, we are looking at new retail formats that will allow us to best meet the needs of consumers in a market like metro New York. When you consider, for example, Manhattan and the different use occasions or need states that our customers have, the idea of having a mobile order and pickup location, it doesn't involve a cafe operation. We think we have strong appeal in terms of how we can improve throughput, better accommodate demand, reduce the lines and satisfy customers as we go. So we see delivery working alongside innovations in retail format in order to best meet the needs of consumers and capitalize on the total demand opportunity.

Nicole Miller Regan {BIO 5884270 <GO>}

So China, important. Digital, critical. But I always come back to Starbucks, for me, most of us at its core balancing that convenience in community. So how do you work to achieve that balance? Is it simply AMS speed and PMS engagement? How do you engage the consumer and balance that?

Patrick J. Grismer {BIO 15965217 <GO>}

Number one for us across all day parts is the customer partner connection. It is the single variable that has the highest correlation with comp sales. When we see strong customer connection scores by market, by country, we will see better comp performance sustain. So that is the goal, number one now. The beauty of that from a throughput perspective, you highlight the morning peak period, which can be quite challenging. As we innovate ways to evolve our service routines and introduce equipment innovation, introduce technology that reduces the administrative burden on our store team, so that allows them to dedicate more their time, energy and attention to customer connection. So it has the dual benefit of improving throughput and freeing up time to drive better, stronger customer connection. So that is the primary focus for sure.

Nicole Miller Regan {BIO 5884270 <GO>}

I've actually -- I'm curious about how the reserve in the grocery stores fit into this equation. So I've been in many of the reserve stores, I'm actually the one in London always fascinates me. I think that's a test reserve store, they do a lot of cool things there. Obviously, you've invited us all into the Roastery numerous times. So how is that as a physical footprint necessary to do the engagement that you're talking about?

Patrick J. Grismer {BIO 15965217 <GO>}

We see the Roasteries as occupying a special place in our portfolio, a limited number of them, because these are flagship retail stores. And as you would expect, the economics are more challenging with those stores. But we believe that it is something that is very unique to Starbucks, something that only Starbucks can do in the coffee category, something consistent with our statures of brand within coffee globally and something it allows us to therefore amplify the brand.

It's a unique opportunity to invite customers who are Starbucks fans or who are new to the concept to understand and appreciate the high-quality that we represent and the innovation that we are bringing to the category in ways that allows us to continue to evolve the offering in our core stores. So the Roasteries serve that purpose elevating and amplifying the brand, while at the same time being a catalyst for innovation in terms of how we drive continued news into our core stores.

Nicole Miller Regan {BIO 5884270 <GO>}

So this next question is tough and I guess, I'm kind of thinking about the U. S. store, because everything is constantly evolving, but I know I get asked this question a lot. How do millennials fit in? So the question is, who is the Starbucks customer today? And how has that changed?

Patrick J. Grismer {BIO 15965217 <GO>}

Well, we feel very good about our customer base globally. What's worth noting in the case of the U.S. is that our recent -- our most recent consumer research has substantiated that we enjoy even higher levels of preference with millennials and

centennials. So we enjoy strength across all demographics, but we see even stronger brand preference, among younger consumers, which I think is a validation of the strength of our brand when you consider that Starbucks has led the growth of the category, we've opened up the category and have invited in effectively through this - the appeal that we've demonstrated with a specialty coffee retail other brands, right? It's actually heightened competition, and yet as competition has intensified, we have maintained our strong position and we are even more preferred by younger customers who see our offering as relevant, innovative, fun and increasingly digital.

Nicole Miller Regan {BIO 5884270 <GO>}

That's interesting to me, too, because when you break it down, they might not be coming solely for caffeine. Sometimes these are caffeine-free beverages. Sometimes it's the act of socialization. So this was also announced back in March at the Annual Meeting, but there's the important aspect of where the -- what the brand stands for. And I -- it seems a big part of that is the \$1 billion sustainability bond, \$100 million to the Valor Siren funds. Are these things that help draw that connection to that consumers?

Patrick J. Grismer {BIO 15965217 <GO>}

They are. I mean, we think very holistically about our brand. Yes, it starts with the highest-quality coffee. It continues with a high-quality experience. But an important aspect of the brand is how we're positioned in the hearts of mine and minds of consumers and partners. I talked about the importance of the partner experience to delivering the superior customer experience. And what we do and what we stand for as a company in the area of sustainability and strengthening communities and so forth is part of the magic that allows us to attract and retain outstanding partners in our stores and inspire and motivate them to provide these extraordinary experiences to our customers. So that is an intrinsic part of what we do, where we look to invest and spend our time, because it is another differentiating feature for the brand that has contributed to the stature that we've enjoyed that has grown over time.

Nicole Miller Regan {BIO 5884270 <GO>}

And the other piece of the equation that's equally, if not more important, is the heart and soul of the brand and this is Starbucks partner. And you recently discussed this as a partner-first mandate. So can you talk a little bit about how important that is that you're serving essentially millions and millions and millions of guests?

Patrick J. Grismer {BIO 15965217 <GO>}

Critically important and certainly, one of the areas of focused investment for us ensuring that our partner compensation programs, including our highly differentiated benefits continue to appeal to and reward the partner talent that is so vital to the health and strength of our brand and continuing to invest in in-store technology that not only enhances that customer experience, but enhances that partner experience. So that the partners are able to devote more their time effort and energy to those customer connections.

So investments in technology that improve or enhance and streamline our inventory management routines that enhance our ability to keep stores looking fresh and clean in a way that we allocate our hours, making sure that as we continue to grow channels like mobile order and pickup that we are making the necessary modifications to our store design to facilitate the delivery of that in-store without disrupting the flow of the product production process for our cafe customers. So lots of different dimensions to what we're doing to enhance, as you say, the partner experience, which is such an important part of what we do and who we are as a brand.

Nicole Miller Regan {BIO 5884270 <GO>}

So it was very helpful that you would agree to kick off, today we talked about the marketplace and the group that we brought together. And so one thing I want to ask you about is, we're going to talk about labor all day, I think probably in most of our conversations. So as an industry, is it getting better or worse than what would you urge us to focus on today in our later conversations?

Patrick J. Grismer {BIO 15965217 <GO>}

Well, it is getting more challenging and then we'll talk about the U. S. And as you would expect, right, with lower levels of unemployment, with the continued growth in the economy and therefore, more companies competing for the same talent. And so that's why it's so important to us to continue to be industry-leading in terms of the unique value proposition that we provide our partners to attract and retain the very best and to motivate and inspire them to deliver their best, but it is getting incrementally difficult.

We believe that we have the advantage of the brand Halo and all of the positive qualities that we represent. Meantime a Starbucks partner, and as I mentioned at the start of our conversation, I feel I'm very excited and quite privileged to be part of this leadership team to be a Starbucks partner. So that is an important part of our DNA and it is part of what gives us that advantage. So as you think about how we all grapple with labor challenges in an environment like this, finding those opportunities to establish a point of differentiation with respect to the employment value proposition is critical.

Nicole Miller Regan {BIO 5884270 <GO>}

Right. It wouldn't be any fun to the talk to the CFO if we don't talk some numbers, so three last numbers questions. If you compare and contrast your past experience, now you're doing commodity purchasing, so what's that like and how about taking price, setting price for the Starbucks products?

Patrick J. Grismer {BIO 15965217 <GO>}

So on the subject of commodities what is different in my experience at Starbucks compared to other companies is that, we are more backward integrated. And I think that speaks to the importance that we placed on the quality of our coffee, the range

of coffees that we offer, what makes that coffee drinking experience so unique and different. So we're more backward integrated. And that also ties into what we're doing from the standpoint of the sustainability and strengthening communities. We're very actively involved in strengthening farming communities in various parts of the world, because that is instrumental to our ability to sustain that supply high-quality coffee, particularly in an environment where coffee prices have been under pressure. That's on commodity so much different.

In terms of pricing, I would say that Starbucks is no different from any other consumer-facing company in the sense that, particularly in a competitive environment, pricing is probably the last lever you would pull, because you want to maintain a strong value proposition. The important thing is that, as you're being more discriminating with your pricing is you're bringing real intelligence, being more surgical in the way that you're taking pricing, considering a variety of factors. And I think that Starbucks is world-class in that respect. And what I've observed and experienced in my brief time with the company is that the tools are becoming increasingly sophisticated. The knowledge and experience that we're gaining, the technology we're planning to customer analytics, understanding customer elasticity of demand in relation to pricing is helping to inform those decisions.

Nicole Miller Regan {BIO 5884270 <GO>}

And then at the end of last year actually, you announced the ideas to action in 100, so that's the number, that's the metric. How is that going? Any examples?

Patrick J. Grismer {BIO 15965217 <GO>}

Yes. We feel very good about the overall progress that we're making towards that goal. And it really started with what our CEO, Kevin Johnson, announced about a year ago under the banner of growth at scale, which is an agenda or framework for how we're thinking about growing off of this position now with more than 30,000 stores globally, and an important aspect of that is evolving the organization in a way that we work. So that we can be more nimble, more agile, responding more quickly to the evolving needs of our customers and our partners.

And so that is sort of the backdrop for this. And I believe that we have made very good progress in streamlining the organization with a more focused agenda and with new tools and capabilities like the Tryer Lab, which we launched in Seattle at our corporate headquarters earlier this year, providing us with focused capability, new space and new mindset to more quickly evaluate new equipment innovations, new store layouts and with the help of our store partners very quickly assess how those will prove our operation and improve the customer experience.

So I can't disclose some of the upcoming equipment innovations. But I will tell you that there are some that have moved very quickly within that zero to 100 days. So that we could quickly qualify the effectiveness and the business case underpinning these investments that we are confident are going to improve the customer experience and the partner experience. So the heavy focus on equipment and store layout.

Nicole Miller Regan {BIO 5884270 <GO>}

Congratulations on that 30,000 store opening that you just mentioned, letting that sink in. Last question, what excites you the most? And how do you think about what will have a more immediate impact on results? And what will have a really long lasting impact on the brand?

Patrick J. Grismer {BIO 15965217 <GO>}

Well, I'm very excited to be joining Starbucks at this point in its history. I feel that the company is actually at an inflection point. With the growth at scale gender, as I mentioned, that Kevin, our CEO, announced about a year ago, that has brought focus and discipline, where perhaps we didn't have it before as a company given the speed with which we had grown. And so I'm excited now to be part of the team reinforcing that focus and discipline that we are confident we'll continue to unlock that next leg of growth and we've seen that in the last few quarters of performance. And so it is that improving performance momentum from a comp perspective, from a margin perspective that I remain confident we will continue to unlock with this new agenda and with a heightened level of focus and discipline.

Nicole Miller Regan {BIO 5884270 <GO>}

Fantastic. Thank you for your time.

Patrick J. Grismer {BIO 15965217 <GO>}

Thank you very much. My pleasure.

Nicole Miller Regan {BIO 5884270 <GO>}

Thank you.

Patrick J. Grismer {BIO 15965217 <GO>}

Have a great day.

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