

ISI Retail Summit

Company Participants

- Duncan Mac Naughton, Unknown
- Greg Melich, Analyst

Other Participants

- Unidentified Participant, Analyst, Unknown

Presentation

Greg Melich {BIO 1507344 <GO>}

By my phone it says it is 11 o'clock so that means it is time to go because with our next presentation, it will be webcast again.

I am Greg Melich. I head up ISI's retail research effort. It is my pleasure to kick off our fourth annual summit with a real special guest, Duncan Mac Naughton, who is Executive Vice President, Chief Merchandising and Marketing Officer of Walmart US. Now just so you understand, that sounds like a pretty important job. He is actually the biggest buyer in the world of anything, period. And then on top of that, he has also got marketing responsibility for the biggest retailer in the world, in the US.

So Duncan, it's a pleasure to have you. As I look around the audience I also see at least a half-dozen of other great Walmart execs. If I tried to introduce each of you, I am going to screw up so I won't. But thank you so much for coming and we will see you all on the tour later. It is a new neighborhood market and so, Duncan, I hand it off to you to take us through why it is so exciting.

Duncan Mac Naughton {BIO 6052579 <GO>}

Thank you, Greg; it is great to be here. Good morning. I really, Greg, appreciate the format today. What is really interesting I love the opportunity to share with you an update on Walmart US and the key strategy which is obviously very important to us and hopefully interesting to you but more importantly is the chance to interact with our stores and as we talk about in our home office, we don't have any registers in the home office because everything happens in the stores. So it is great that you will be able to interact with some of our leadership that will be able to talk to you about where we are making some big bets on innovation inside our neighborhood markets and we are pretty excited about it.

The store we are going to go to actually used to be a Food Lion before they left the marketplace. So I think you are going to see some great merchandising on the floor and I am pretty excited about it. So with that we are going to jump in.

I will be making some forward-looking statements today so rather than read this to you and expire my shot clock down here, Greg, I am going to let you go to our corporate website if you'd like to read more about this and you can find more information there.

So again, we are delighted to be here. So let's jump into business. Let's be real clear, our number one priority at Walmart US is to drive positive comp sales, period. And that is what we are focused on. And we are focused on doing that by building the next generation of retail and what was exciting and what I just heard about from the panel here is you are going to see some of the work that we are doing at Walmart to connect all our formats to basically endless aisles and shop when the customer wants to shop. We think that is critically important.

Our core mission remains the same at Walmart. It is about saving people money so they can in fact live better and we do that by taking costs out of our business system whether it is our operating environment, whether it is our cost of goods and then we invest that in lowering prices and have price leadership across the country. And low price leadership will always be a foundational pillar in the Walmart US strategy.

We take those great prices and we put them across a very broad assortment to fulfill our one-stop shop commitment to our customers particularly as we think about the Walmart Supercenter. It is about top brands, it is about innovative items and also as we get into smaller formats, it is about localized assortment that resonates with the customer. And you will see that particularly in a neighborhood market as food is very local in nature and we will demonstrate for you that a couple of examples here but also as we get into the store.

And you heard about the customer changing in that presentation this morning but people are shopping differently and they want access when they want it and as a result, we thought it was very important to accelerate the rollout of our neighborhood market and our express stores and I will talk to you more about that but on the chart you can see there by the end of the fiscal year this year, we will have approximately 650 of those stores on the ground at Walmart.

What is most exciting is we think at Walmart we are in a unique position to win in this convergence of physical and digital retail because we have that forward place footprint, we have very strong buying power, great loyalty and price leadership. And connecting that digital comp customer with that brick-and-mortar customer we think is going to win and we think we are positioned for that and I will give you some examples about that as we go through.

What gets those low prices is driving that productivity loop that I talked about. We are always looking at ways to optimize our supply chain, our operations. As a

merchant we are very focused on our cost of goods savings, it's taking cost out of the business and taking those savings and putting them back in price.

Last year we saved over \$600 million in cost of goods savings and we intend to have additional savings again this year. We take that again and put it into our price.

We have four platforms that we pursue as we think about how we work with our suppliers. The first one I will talk about is what we call our joint business planning process which is a framework for us to have conversations with our strategic supplier partners talking about where we are going to invest, where we want to grow, where perhaps we are mutually going to invest to disrupt the marketplace, set growth targets and it creates that environment of metrics, quarterly updates and holding each other accountable for activities.

We now are working with about 200 suppliers which is almost double than what we had in last fiscal year and just slightly over half our sales are now done with partners that we use in joint business planning. We started this primarily with our grocery and our consumables and OTC suppliers but this now is across the total store with general merchandise and our softline partners as well which I think is critically important.

The secondary focus for our merchandising team is now food upstreaming work and we have had some great progress here. This is really about how we can decrease product cost while we increase product quality. It is that simple, simple in concept. But it takes some work to do. Some of the examples that we have done is we have now have three wine warehouses across the United States in California, in Florida and in Arizona. We are able to take cost out of the distribution center and then reflect that cost back to the customer.

In produce which I am very excited about, we are able to use regional facilities to start to centralize some of the produce supply chain activities, things like culling and things like quality assurance ripening, cutting, packaging and even sorting across an entire crop to say which stores should get which products. We opened our first facility in South Texas in the Third Quarter of last year and we plan to open five more of these facilities in the coming years.

In global food sourcing, we are also adding some more locations that I will talk about in a second. I will tell you, one of the other areas down here in global food sourcing is about taking a strategic supplier matrix and looking at building stronger, longer-term relationships that are more meaningful with our key strategic supplier partners particularly in general merchandise and soft lines. That gives them an opportunity and us to have multiyear commitments so we can invest in innovation and we can invest in quality improvements.

The direct sourcing in both GM and softline has continued to grow. It allows us to buy direct. It allows us to enhance our margins and it takes cost out of the supply chain and also allows us to forward manage our inventory.

Some of the other global sourcing highlights would be for instance in our own brand and in entertainments and accessories. We took out the middleman in electronic accessories, went directly to the pilot to the factories and we are able to have in our stores you probably see them in our Supercenters, the \$4.88 accessory bins. It would be phone cases, it would be ear phones. And great ways to create great value and take cost out of the supply chain by working directly with our supplier partners.

Another example is the appliances there. We launched the Farberware brand again dealing directly with our factories overseas and that allowed us to grow margins and take supply chain costs out and actually have better quality product that is comparable to leading brands at disruptive prices.

And then finally in the fourth plank for our merchants is the US manufacturing initiative that you have heard us talk about and I know you have heard Bill talk about before. We really are building on the foundation we laid last year to hit our commitment to buy \$250 billion of US manufactured goods by fiscal year 2023. This is pretty exciting. As a matter of fact, we now are working with 150 suppliers. We have 170 projects that are live today and we are actually going to -- I am excited about our second annual US manufacturing summit that we will host this summer with 500 suppliers and a number of state agencies and representatives to talk about how do we accelerate processes and move this forward. So it is a critically important initiative for us.

So we got those cost of goods, what do we do with them? We are very aggressively investing in price and the way we look at it is across basket elasticities, we always lead on the key volume items as you know but the key here is where can we invest to get the best return on our investment across our shoppers whether it be a Supercenter or a neighborhood market? What are the traffic driving categories where we want to disrupt and make a difference? And you have heard us talk about adult beverages for instance. It is a great example of how we can drive traffic and also drive topline sales.

And then finally, localized customer needs particularly in food where it is a very local marketplace so we look at different geographies where we think we can have an inflection point to drive topline sales and convert some traffic. And we are being very bold about how we talk to our customers about it and you can see there on the left side our March Rollback Madness event which is really exciting.

You can see an example of the tab that we have there. The products now between March 1 and March 31, the front page has got some great local brands things like Coca-Cola for \$3 for example and we now have 20% more rollbacks in this particular event than we typically would have. So not only having great everyday low price but activating that across the store through our merchandising and our rollback sign which really resonates well with our customer. So we will continue to invest aggressively across the key commodities.

What is fun here is how do you innovate to make savings easier and you are probably familiar with our Low Price Guarantee and we back that with an ad match. If for some reason some retailer would beat us with their high low price, we match it at the register as you may be familiar with as the customer checks out.

So what we are going to do here is a pretty exciting program we are calling Savings Catcher and this is actually a way that a customer goes in the store, they buy their product, they get their receipt, they take the number off the bottom of their receipt and they can either go online or do it from a mobile application and type in that receipt number. Then what we do is we look at all the ads across all of the marketplace of the products that they bought in their basket and if we were beat on any of those items, we automatically credit that savings to a Walmart gift card and that will create a credit for them that they can come back and buy whatever they'd like with it. And we are very excited about this.

We are testing it now in seven cities. We are in Charlotte, North Carolina, Lexington, Kentucky, here in Atlanta this week, Minneapolis, Dallas, Huntsville, Alabama and San Diego and we are also talking about it across different weights with TV, with radio, with in-store promotions, our smart network social and digital media. So we think this could again be a great asset for our customers again giving confidence to our customer that we are in fact the low-price leader across the whole basket.

Now driving traffic and having our commitment to the one stop shop is critically important and we do that with winning in new and winning with brands that resonate with our customers. So making sure we have the top brands and that we are first to market and oftentimes exclusive to market and then how we bring that to life in the store.

A couple of examples here on this slide is the first on the upper left you can see Bud Light's extension of their original Lime-A-Ritas. They have got some new products out. Don't know if you have tried them. They are very good and they will be for sale and where you are welcome to buy them and maybe enjoy them this evening. Mango-Rita and Raz-Ber-Rita flavors to the Bud Light Lime. We have a 41% and a 42% share on these products nationally. So again, getting out in front of the marketplace, having great prices, making it available to the customer and leading with innovation with our supplier partners is really important.

You combine that with Lime-A-Rita and Straw-Ber-Rita and we will have a \$100 million business in these four SKUs. That is about being relevant with the customer.

The other piece you can see in the upper right there is we are launching a private label price first opening price point brand that we are very excited about. We have got 55 SKUs in this line. We are currently in 400 stores. We are going to expand that to another 240 stores. We call it fit for purpose so it's product that will meet the customers' expectation for the value that they pay for it and the packaging reflects our commitment on that.

So we think this is a great opportunity to make sure that we have the lowest price in the marketplace and we can build this across the stores.

Other items that are exclusive. For instance I just highlighted the Red Lobster cheddar biscuit mix. It is a great product that really resonates with our customers. Crazy how well it sells. We have exclusivity there until June.

On the left you see the Urbini Hummingbird Stroller. Our customers told us you have nice strollers but not good enough. This is a higher end stroller. It's seven pounds, why we call it the Hummingbird. So you can hold the baby in one hand and you can open and close the stroller. It is a fabulous value and we are very excited about it.

Then we are taking some of our existing brands and expanding them like the great workwear product that we have in Dickies. We have now moved into high quality workboots as well and that brand resonates with our core customer who shops with us for their workwear. It is now into our work shoes.

And then the Flexees brand by Maidenform as you may know, the shapewear industry has been growing quite quickly and we started with a pallet program last quarter with Flexees and now putting it in our spring modular and it is a great program where we will have savings for our customer 50% to 60% off the national department stores.

We have a camisole that is \$15.94 that would be about \$60 in some of the national department stores so shocking value as we like to call it at Walmart.

Some of the big bets and some of the mass merchandising ideas, you may have read yesterday we announced that we are going to participate in the videogame trade-in business. We are very excited about this announcement. We will actually start it in 3100 stores a week from today and today actually we will start it with our associates so they are able to bring in their games and it is across the great platforms like Sony PlayStation, Microsoft Xbox, Nintendo Wii and as you may know, this is a \$2 billion industry that we don't participate in yet.

So we will trade them in and as we fill our supply chain, we will then put those products for sale. We assume we should be able to sell them by summer so another great revenue stream. Paying more for games for our customers and selling those used games for less, again creating access for our customers.

Other things like big bets on what we call consumables in our general merchandise area like as the incandescent lightbulbs fade out, we are making a big bet on our GE as well as our great value lightbulb business and the LED as well as the CFL business where we have about a 30% price gap to our competitors.

And then on the bottom, this is a bit of what you expect from Walmart, item price merchandising. It is the stock up and save events we started running last fall. We are

doing it again this March, you are going to see it in Supercenters. You also see it in select neighborhood markets, things like Charmin and Bounty paper towels and Pampers diapers at a significant savings for the customer with big displays, again showing the customer that we lead in price across all the core commodities.

We also continue to build on our improvements in our fresh food business. We see this as a strategic pillar for us not only from investing in price but more importantly for our customers in quality and we are going to build on the momentum that we launched two years ago in our meat business with our choice beef program and then last year with the work we did in produce and I will highlight that in a minute.

But we are adding some regional brands for instance our chicken brands, Claxton Foods in the southeast part of the United States. Frozen patty brands that we didn't have before like Guy Fieri and Herschel's Famous 34 and also adding more healthy items within the fresh meat case particularly in the pork lines like thin cut chops and petite butt roasts. So some of these items the customer has not been able to get before to make sure we are relevant.

Also driving promotional activity to get customers to come into the fresh department like a national fresh turkey program that we have with Jennie-O as well as Butterball. And then improving the produce operation is really exciting. We had a great year in produce as we shared with you with the end of the year. We grew 50 basis points in share between meat and produce last year but when we started this program we audit our stores and the first time we did an audit in May of 2013, only 75% of our stores passed our expectation of good quality produce. The last six weeks, the audit was 95% pass rate. So the operators have done a fantastic job.

We have also worked with our supply chain to take two full days of supply out of the produce supply chain so that means our customer is going home with a much higher quality pressure product which resonates and is reflected in that share growth. We are going to take that same focus and put it in our service deli and our bakery with authentic baked daily products in the Walmart bakeries to get that engagement with food and we are pretty excited about that. It is going to build -- and in fact customer loyalty and trust some great items like you are going to get a chance to eat so make sure you have some dessert at our store. Some market side chocolate chip cookies, a three pack for \$0.98. It is out of this world. So I encourage you to try that when you get to the store.

The other key thing is we talk about how do we tailor our offers to make sure that we are relevant locally. So we are adding the regional brands like I talked about in fresh. We are filling assortment gaps where perhaps we didn't have insight to items carried in a local market before so we are leveraging our syndicated data from Nielsen and IRI and NPD in the nonfood areas to make sure that we are in fact relevant.

In the store we are going to go to this afternoon you are going to find products for instance that you might not find in Bentonville or Philadelphia, Southeastern Mills gravy mix which is made in Rome, Georgia; Williams Brothers barbecue sauce that is

made right here in Marietta, Georgia; Rogers wood smoked meats that is made in Savannah; and then a Vidalia brand onion ring batter mix that is made in Reidsville, Georgia.

So not only having the right items but then having the right holding capacity. So we have built demand-based clusters to make sure our modulars have holding capacity for high velocity items but to make sure we are locally relevant.

You have heard Bill talk about the acceleration of our neighborhood markets and our small store formats. We will add 200 Neighborhood markets this year and 100 Express stores. These are very much focused on the fill-in trips. People expect us for key traffic driving like fresh foods, you see pharmacy, adult beverages. It lives inside the Walmart ecosystem where we are going to have fuel, where we have room for fuel. We can tether products from the big stores to the small stores for meal solutions and all the Walmart services like site to store you heard pick up today talked about today and also our money services center. So we are excited about the opportunity to take that small store and let it behave like a big store.

And that is all about integrating our digital and physical initiatives for our customer. We are investing heavily in our mobile capabilities. You are familiar with the Walmart app and all the features that it goes with. The customer choice you heard the panel talk about people want to order it online, they want to pick it up in their store, they can pick it up the same day, they can pick it up a few days later for free, they can order online and pay with cash. We still have our locker test going on in Washington, DC in 10 stores.

The exciting news here is on the bottom of the page which is what we launched in October in 2013 in Denver was a grocery home delivery service which was the second market after we started in San Jose. What is exciting about this is we are delivering throughout the Denver market the same price as in store as online. We don't have an annual fee. We have free for new customers and a very modest delivery fee and we just launched in January pickup from the store for free.

So order online, have your groceries. You are on the way home, you want to get gas or just pick it up and go, we now have that at 29 locations across the Denver market and we have a 90% approval rate from our customers. And our brand with King Supers and some great retailers in Denver, we feel really good about the opportunity here and we have been growing market share in the Denver market and we think this is a key opportunities for us to learn and grow.

Our customer is changing and we need to talk to them differently. So we are sharing our message across with our customer whether it be in-store promotions on their phone, through their social networks, online, in radio, on search media like you heard from the Google folks and we are also investing significantly in digital and social media, increasing our investment this year 30% across these areas. From Facebook, we're still the number one brand in the United States, Pinterest, Twitter,

Vine, Instagram; we also have content videos on YouTube that we are very excited about.

And we are also launching some new innovative programs. One example would be our weather FX program and this is working with weather FX to identify emerging weather patterns and then triggering advertising direct to customer.

So for instance in Atlanta, you wake up maybe it is 55 degrees out this morning, 30% humidity by this afternoon it is 70 and 90% humidity. That would trigger for instance Gatorade ads or bottled water ads. It would go directly to the store's Facebook page to mobile applications and to our in-store network.

Same thing with pollen count when it rises, we would immediately start to feature over-the-counter medication as well as all the other things folks are looking for.

So priority is quite simple, drive comp sales by investing in price. We are very focused on price separation and price leadership. Number two, deliver the best assortment with top brands and innovative products and being local, using data to be local. The convergence of digital and physical is really important and that is why we are growing the small store format so quickly. We want small stores acting like big stores combined with Walmart.com basically unlimited assortment.

And then customer connection with all the different ways we can talk to the customer in-store and then testing and innovating which you will see some of that in our stores today.

So I am excited about the opportunity that we have with Walmart. We are all focused all 1.3 million of us on driving topline sales and positive comp sales for the year. So with that, I will take some questions.

Greg Melich {BIO 1507344 <GO>}

Maybe I will kick it off with one and then we will get to the group. This last holiday it seemed like it started really strong and the initiatives and investing in price and TVs and everything really came on and then of course weather and other things disrupted it. Now that we can look back at that and go into this year, what do you think we learned from this holiday in terms of getting that balance that there is deflation out there and traffic is down, how much we reinvest and how we reinvest it to stabilize traffic?

As you think into this year, should we expect gross margin you want to keep investing in price as much as last year or do you think last year got a little bit overboard by the Fourth Quarter?

Duncan Mac Naughton {BIO 6052579 <GO>}

It's a great question. We actually reflecting specifically on the Fourth Quarter, we feel really good about the holiday activity. As a matter of fact, we are already planning as you would expect us to do what we are going to do this holiday. I felt good about it. As a matter of fact going at the end of December, we had positive comps.

What really hurt us was the January weather. It just really disrupted our place. You can expect us to invest in gross margin and in price for the year because we believe it is going to drive traffic and it will drive price separation in the business. So you will continue to see that. That is why we have the cost of goods initiatives that we have. We will always be working the productivity (inaudible).

Greg Melich {BIO 1507344 <GO>}

Great.

Questions And Answers

Q - Unidentified Participant

I have two questions actually the first one is a real quick one. I have seen that 28 AGs have asked a whole bunch of retailers including you to stop selling tobacco and I just wondered if you could make a comment on that and then I will ask my other question.

A - Duncan Mac Naughton

 {BIO 6052579 <GO>}

Yes, we have gotten a few letters from some senators. Our role at Walmart is really about providing customer choice and while a product is legal, it is similar to the gun debate that we had not too long ago and as long as the product is legal, we will sell it legally and we will still offer the choice of tobacco for our stores.

Q - Unidentified Participant

Okay. And then in Denver, you've just recently started with the food test order online and pick up in-store. Some of the studies I have read show or say that people don't actually mind going to the grocery store. They just don't want to spend so much time there. So have you seen yet people actually they order online but they come to the store and they shop the meat and the produce and then they pick up the center of the store on the way out because that is what actually they don't want to shop for. Have you noticed anything yet?

A - Duncan Mac Naughton

 {BIO 6052579 <GO>}

My experience in the industry is exactly that. People actually, they are comfortable with you picking their canned soup or their boxed dinners but they want to pick their tomatoes. And that is why we are really excited about this Denver test so we can see some of those learnings. I expect that to be the case and that is why we want to make it convenient and that is why we are in 29 locations. I think this could be a big win for us.

A - Greg Melich {BIO 1507344 <GO>}

I can't resist given the tobacco question. You mentioned Denver. If it is legal. Are we doing more local merchandising in Colorado?

A - Duncan Mac Naughton {BIO 6052579 <GO>}

No, sir. We are going to follow the Federal law.

A - Greg Melich {BIO 1507344 <GO>}

Thank you for that.

Q - Unidentified Participant

I want to ask about the role of pharmacy and gas station in both the Neighborhood Market and the Express stores. I know they are both desirable maybe just out of the 200 Neighborhoods, the 100 Expresses, how many pharmacies, how many gas stations do you think you will be able to build?

A - Duncan Mac Naughton {BIO 6052579 <GO>}

I will tell you that our goal is to build fuel stations and pharmacies in every store where we can unless there is a restriction because of location of the store. Other than that, we are going to put them on the ground. We think we can differentiate because of the pharmacy, because of fuel, because of fresh foods that a lot of the smaller dollar store channels can't offer and we think that is a great competitive advantage for us.

So where we can you can expect that which would be the majority of the sites we have.

Q - Unidentified Participant

(inaudible) closer to 90 than 50?

A - Duncan Mac Naughton {BIO 6052579 <GO>}

I would say probably almost virtually almost all. It would be an exception not to have those services. Is that fair?

Q - Unidentified Participant

Thank you.

Duncan, can you give us an example of a product that was very innovative that was a big deal to you guys last year in your stores or something now that we can look at today? I mean we see so many things but your eye is different so an example or two of really cool innovative products. Thanks.

A - Duncan Mac Naughton {BIO 6052579 <GO>}

Sure. You bet. Some of the food innovation you saw some of the things in alcohol that we really assuming -- do we have alcohol in the store? Beer, beer only. Okay so beer and wine, which is for the most case what we sell a lot of. We sell a lot of beer and some wine and some spirits based on law.

Innovative products, some of the things that we work with on our private brands for instance where we co-branded some products with Pepperidge Farms both in our refrigerated dough and also with Betty Crocker building some macaroni and cheese products, some home meal side dishes that are borrowing off national brand equity but are made by our third-party supplier and exclusive to Walmart at significant values to the customer.

And you wouldn't think center of the store would be one of those areas where you could go but we had some great work and we can highlight some of that for you in the store.

Q - Unidentified Participant

A question about the small format rollout. I think US Walmart stores do about \$400 billion of revenue and if small format is successful maybe it gets to \$16 billion or \$17 billion in a number of years. Could you just talk about how you and other management are spending your priorities trying to get 4% revenue growth? Is it just noise and you are missing the core or how do you balance the two initiatives?

A - Duncan Mac Naughton {BIO 6052579 <GO>}

Yes, that's a great question. Our US business is about \$290 billion and so it would be smaller than that in the smaller stores. We do see opportunities for thousands of small stores, Neighborhood markets as well as that is why we rolling out the 100 Express stores. So we think we can be a big business tens of billions of dollars over time without any problem.

We have a team that is dedicated to our small store rollout and you are going to actually get to interact with them at the store today so that the bulk of the organization can work on the \$285 billion call it worth of sales that we do on the big stores.

We do use the same buying teams because we don't want to fracture that leverage so what we do is we rely on the experts of the format to tell us what they need differently and then our buyers negotiate on behalf of the greater Company.

Q - Unidentified Participant

I had a quick question because there was a lot of information to take on. On the Walmart to go trial, I know you are saying it is mostly click and collect but how does the charging work and also are you going to offer a delivery to home part to that as well? Thanks.

A - Duncan Mac Naughton {BIO 6052579 <GO>}

Sure. The pickup at the store is free and then the delivery is a \$30 minimum basket and it is either a \$5 charge or a \$7 charge depending if you want a one-hour window or a four-hour window. And there is no annual fee. And I think some other folks might have a \$35 minimum and a pretty substantial delivery fee.

A - Greg Melich {BIO 1507344 <GO>}

That's great. Well, Duncan, I want to thank you very much. We could go on for an hour with you. So we will have the chance at the store. You will be at the store along with another whole group of great Walmart people so thanks again for coming.

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