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**HNI Corp.** (HNI)

Q1 2021 Earnings Call

## CORPORATE PARTICIPANTS

**Matthew McCall**

*Vice President-Investor Relations & Corporate Development, HNI Corp.*

**Jeffrey D. Lorenger**

*Chairman, President & Chief Executive Officer, HNI Corp.*

**Marshall H. Bridges**

*Senior Vice President & Chief Financial Officer, HNI Corp.*

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## OTHER PARTICIPANTS

**Greg J. Burns**

*Analyst, Sidoti & Co. LLC*

**Reuben Garner**

*Analyst, The Benchmark Co. LLC*

**Kathryn Ingram Thompson**

*Founding Partner & Chief Executive Officer, Thompson Research Group LLC*

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## MANAGEMENT DISCUSSION SECTION

**Operator:** Good day and thank you for standing by. Welcome to the HNI Corporation First Quarter Fiscal 2021 Conference Call. At this time all participants are in a listen-only mode. After the speaker's presentation there will be a question-and-answer session. [Operator Instructions] Please be advised that today's conference is being recorded. [Operator Instructions]

I would like to hand the conference over to your speakers today. Matt McCall, please go ahead.

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**Matthew McCall**

*Vice President-Investor Relations & Corporate Development, HNI Corp.*

Thank you. Good morning. My name is Matt McCall. I'm Vice President, Investor Relations and Corporate Development for HNI Corporation. Thank you for joining us to discuss our first quarter fiscal 2021 results. With me today are Jeff Lorenger, Chairman, President, and CEO; and Marshall Bridges, Senior Vice President and CFO.

Copies of our financial news release, earnings presentation, and non-GAAP reconciliations are posted on our website. Statements made during this call that are not strictly historical facts are forward-looking statements which are subject to known and unknown risk. Actual results could differ materially. The earnings presentation posted on our website includes additional factors that could affect actual results. The corporation assumes no obligation to update any forward-looking statements made during this call.

I'm now pleased to turn the call over to Jeff Lorenger. Jeff?

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**Jeffrey D. Lorenger**

*Chairman, President & Chief Executive Officer, HNI Corp.*

Good morning and thank you for joining us. This quarter our members again demonstrated much of what is unique about HNI. We delivered substantial profit improvement, showing the power of our diversified revenue

streams, our ability to react quickly to changing market dynamics, and our strong operational capability. As we look to the remainder of 2021 and beyond, I am increasingly optimistic about our enhanced competitive positions and ability to drive profit growth.

We have two differentiated business segments, well-positioned to benefit from a recovery of the cycle, multiple secular trends, and numerous HNI specific growth initiatives. We have a track record of effectively deploying capital, driving annual productivity and cost savings, and clear opportunities to drive shareholder value.

On today's call, I will cover three highlights of the first quarter. I'll go into each in more detail in a moment. But in summary, they are: first, our Residential Building Products segment is hitting on all cylinders and we expect a strong performance to continue; second, demand in Workplace Furnishings, while down versus last year, is recovering; and third our incremental profit margins in the first quarter demonstrate the strength of our model. After covering the detail of those highlights, Marshall will then provide some color around our second quarter outlook. I will conclude with some general comments. Finally, we will open up the call to your questions.

The first highlight is profit in our Residential Building Products segment nearly doubled from year-ago levels. Our members responded to stronger-than-expected demand, while maintaining our high levels of service and delivered strong incremental profit. We generated 37% percent year-over-year revenue growth in the first quarter or 39% including the impact of acquisitions.

Operating margins in this segment expanded 600 basis points from prior-year levels, which drove year-over-year operating income growth of more than 90% in the quarter. Remodel/retrofit sales grew 55% versus the prior year as we continued to capitalize on strong activity in this market, drive our growth initiatives, and leverage our supply chain strength. New construction sales were also strong, growing 24% year-over-year on an organic basis. Again, our value propositions, growth initiatives and supply chain strength continue to resonate with homebuyers and builders.

As the first quarter progressed, activity accelerated. As a result, our first quarter growth rates in this segment were higher than we expected. Specifically, normalized orders grew at a 40% year-over-year rate in the first quarter and strengthened as the quarter progressed.

As we look forward, there's a lot to be optimistic about. We have a strong competitive position. Our vertically integrated business model, unmatched product depth and pricing breadth, strong builder relationships, and regional distribution infrastructure all provide differentiation for this business. We are currently benefiting from a historically strong housing cycle, supported by long-term demographic trends and a persisting housing supply demand imbalance. We're also seeing secular support tied to nesting and de-urbanization trends. And we have an outstanding opportunity to grow the category in both new construction and remodel/retrofit.

As a reminder, in new construction, two-thirds of homebuyers see having a fireplace as a must have feature of the home but less than 40% buy one. And on the remodel/retrofit side, we estimate that less than 3% of all remodeling projects involve a fireplace.

To take advantage of these opportunities, we are driving a better connection with the homebuyer and homeowner and are making investments to influence their home purchase or remodeling journey. We continue to invest in enhanced direct and digital marketing. We continue to partner with social influencers in targeted media to drive overall awareness demand. And we continue to develop visualization tools to help guide homeowners as they explore options.

By combining these new efforts with our unique and differentiated model, we are competing better than ever in this space. Our revenue growth and margin expansion in the quarter reflect the power of this business and make us optimistic about the future.

Our second highlight for the quarter was in our Workplace Furnishings segment, which is showing multiple signs of improvement. On an organic basis, net sales in the segment declined 12% and orders declined 10% versus the prior-year period. These were the lowest rates of decline since the beginning of the pandemic and orders over the past five weeks were above prior-year levels. The order improvement was led by our business focused on small- to mid-sized customers.

We are seeing momentum in the public sector with national supplies dealers and in smaller markets. We are driving growth in our e-commerce and international businesses which generated double-digit order growth in the first quarter versus the prior year. In contrast to those areas of improvement, the contract market continues to be impacted by the pandemic. Orders in our contract businesses were down over 20% from the first quarter 2020 levels.

As we look ahead, although conditions remain dynamic, we believe we are turning the corner in Workplace Furnishings and expect to drive revenue growth next quarter and through the remainder of the year. That outlook is based on the combination of our agility and our competitive position with small- to mid-sized customers, generally improving demand trends and easier comps.

In our contract businesses, we are seeing initial signs of recovery in our preorder metrics and dealer activity. However, we expect demand from larger contract customers to recover more slowly than other parts of the business. We believe the contract recovery depends on the timing of office re-entry in major markets. That timing remains somewhat uncertain and likely tied to vaccination rates and school re-openings. Most customers continue to indicate activity will ramp sometime in late Q2 through Q3. As a result, we expect year-over-year revenue growth in our contract businesses to accelerate in the second half of the year.

Our differentiation of Workplace Furnishings' business model positions us well to compete as the market recovers. Our Workplace Furnishings businesses have unmatched price point breadth, channel access and market reach. These differentiators position us as well to benefit from office reentry, work from home, and de-urbanization trends. As a result, we expect to continue to outperform the market.

Our third highlight for the quarter was our strong incremental margins. We reported a total company year-over-year incremental operating margin of 60% in the first quarter on a non-GAAP basis. This strong performance was driven by volume leverage in Residential Building Products, the benefit of our annual cost savings and net productivity initiatives, and from permanent cost actions taken last year to combat pandemic pressures. Our first quarter incremental profitability demonstrates the long-term potential of our business model.

I will now turn the call over to Marshall to provide some additional detail around our first quarter and our outlook. Marshall?

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## Marshall H. Bridges

*Senior Vice President & Chief Financial Officer, HNI Corp.*

Okay. Let's start with our second quarter outlook for the Residential Building Products segment. Recent order trends, housing construction activity and expected benefits tied to our multiple growth initiatives all suggest second quarter growth rates in excess of 30% from the prior-year quarter. We continue to see strong momentum with both remodel/retrofit and new construction.

Let's shift to our outlook for Workplace Furnishings. For the second quarter, we're expecting revenue growth driven by improving order trends of small to midsize customers, public sector activity and a low prior-year comparable. For the segment overall, we expect a second quarter revenue growth rate in the low teens on a year-over-year basis. That growth expectation includes the impact of Design Public acquisition, which will add approximately 2.5 percentage points to our second quarter growth rate in the segment.

Next, let's move to second quarter profitability. Overall, we expect second quarter non-GAAP EPS to be up over prior year levels, despite inflationary pressures, growth investments and return of temporary cost actions taken in the prior year. Higher volume levels and net productivity will more than offset those headwinds. However, the mix of these factors will result in a low-incremental margin for the second quarter.

We do expect incremental margins and operating profit growth to accelerate nicely in the second half. As Workplace Furnishings' volume improves the anniversary, our temporary prior cost actions and our price increases implemented in response to recent inflationary pressures become effective.

Finally, some comments on our cash flow and balance sheet expectations. We ended the first quarter with \$176 million of total debt. That was mostly unchanged from last quarter and down from \$230 million in the first quarter of last year. Our quarter ending cash balance was \$94 million, which represents an increase of \$59 million in the first quarter of 2020. Our gross leverage ratio of 0.9 was slightly improved from last quarter and last year. We expect free cash flow to continue to be strong this year, which will provide ample capacity for continued growth investment, dividend payments and opportunistic M&A and buyback activity.

I'll now turn the call back over to Jeff.

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## Jeffrey D. Lorenger

*Chairman, President & Chief Executive Officer, HNI Corp.*

Before we take your questions, I want to highlight our recently published Corporate Social Responsibility report. Last quarter, we discussed our 2018 CSR report and our initial ESG goals. Our new report announced multiple new targets, including among others, our goals to achieve 100% supplier compliance with HNI's Code of Conduct by 2022. This includes requirements related to ethical and sustainable material sourcing, to use 100% recyclable packaging by 2025, to achieve zero waste to landfill for all facilities by 2030, and to reduce our energy intensity 50% from a 2018 baseline, and reduce Scope 3 greenhouse gas emission 40% per ton of goods by 2035.

In addition, we will continue to source 100% renewable electricity across our global footprint. And annually, we will continue to donate 1% of our pre-tax profit to improve the quality of life in the communities in which we operate. I'm impressed by the desire of our members to enthusiastically embrace these initiatives for the betterment of the organization, our communities and our world.

Let me wrap up by stating that, as we look forward, we are increasingly optimistic and expect accelerated profit growth as we progressed throughout the year. We have two differentiated business segments, each well-positioned to benefit from a recovery of the cycle, secular trends and HNI-specific growth initiatives. We are well-positioned to grow revenue, expand margins and generate and effectively deploy cash over the long-term. I would like to conclude by stating I'm extremely proud of and grateful for the efforts of all HNI members.

We will now open up the call for your questions.

## QUESTION AND ANSWER SECTION

**Operator:** [Operator Instructions] Your first question comes from the line of Greg Burns with Sidoti and Company. Your line is open.

**Greg J. Burns**

*Analyst, Sidoti & Co. LLC*

Q

Good morning. On the Building Products – for the Building Products segment, would you characterize the growth as coming from market share gains or primarily from market share gains or from category retention that you've been talking about for the last couple of quarters?

**Jeffrey D. Lorenger**

*Chairman, President & Chief Executive Officer, HNI Corp.*

A

Yeah. Greg, let me – I'll comment on that. I would say first of all, just to think about the quarter, we had expected growth kind of in the mid-20% range and that was consistent with our Q4 and mid-quarter remodel/retrofit really accelerated and orders were up 55%, as I said, year-over-year in the first quarter. And it's driven really by two factors. One, our growth initiatives continue to gain traction. And I'll give you a couple examples here. Our insert sales are up more than 80% year-to-date. Website traffic awareness consideration and purchase visits are up over 60% year-to-date. And our electric category sales are up over 100% year-to-date. And each is tied to a specific growth initiative that we've been working on.

And then the housing remodel markets are strong. The inventories are low. As you well know, mortgage rates are hanging in there. Home equity, people have it. They've got savings. And so we're connecting better with homebuyers and homeowners and taking advantage of the marketplace. And on top of that, we have a really strong model. As I commented, we've got great products. We've got supply chain strength. We've kept and maintained our service levels throughout the pandemic. And with our vertical integration we've really been able to service our customers. And I think all that combined is what's driving the growth.

**Greg J. Burns**

*Analyst, Sidoti & Co. LLC*

Q

Okay. Great. And then is there a way to quantify maybe how much bigger the – how much the category can grow if you move from two-thirds attach – from that 40% to two thirds attach rate in the new construction market? What each maybe percentage point equals in terms of maybe revenue potential or market expansion?

**Marshall H. Bridges**

*Senior Vice President & Chief Financial Officer, HNI Corp.*

A

Greg, over the long term, if we're able to move from less than 40% of homeowners putting in a fireplace and new construction to that 66% or 67% that this is a much higher feature, that'd be worth like 50, 60 points of growth for the industry as well as us. So it's very meaningful. It's going to take some time to get there though.

**Greg J. Burns**

*Analyst, Sidoti & Co. LLC*

Q

Okay. All right great. Thanks. And then on the Workplace side, is this like kind of typically what you see coming out of a recession, the supplies, the SMB moving [indiscernible] (15:54) than you see the contract piece following

through? Is this kind of following a pattern where it gives you confidence that you do see those contracts, larger projects coming through?

**Jeffrey D. Lorenger**

*Chairman, President & Chief Executive Officer, HNI Corp.*

A

Greg, let me comment on that. Typically, I'm going to do with an asterisk. The answer is yes but some of it is similar and some of it may be a little different. Typically, we do see that because the shorter-cycle business and it comes out first in the contract market as a longer sales cycle and projects are more complex, they take longer. And that's some of this. This recession with the pandemic is a little more unique though. So I think that is some of it, but it's also just some of the smaller businesses in smaller markets are – where there's less mass transit, are open and starting to come out sooner. So, it's either coming out sooner but maybe for a little bit different reason. But we expect it to probably operate in a similar fashion even with this pandemic.

**Greg J. Burns**

*Analyst, Sidoti & Co. LLC*

Q

Okay. Great. Thank you.

**Operator:** Our next question comes from the line of Reuben Garner with The Benchmark Company. Your line is open.

**Reuben Garner**

*Analyst, The Benchmark Co. LLC*

Q

Thanks. Good morning, everybody.

**Jeffrey D. Lorenger**

*Chairman, President & Chief Executive Officer, HNI Corp.*

A

Good morning.

**Reuben Garner**

*Analyst, The Benchmark Co. LLC*

Q

So, just a follow-up on the Building Products piece, and I hate to beat a dead horse, but you guys are clearly growing faster than any other categories, at least that I know of, in the Building Products space. How much of it do you think you attribute to the fact that you guys have been able to execute and have the products available versus maybe some other categories or your competition? And do you feel like your competition is getting back to the point where they're able to run their factories and their supply chains efficient enough to participate in the growth going forward or do you expect to continue to kind of pick up share from some of the same reasons that you have over the last several quarters?

**Jeffrey D. Lorenger**

*Chairman, President & Chief Executive Officer, HNI Corp.*

A

Well, that's, Reuben, that's a good question. I think that our model is going to continue to perform well. That's why we're so optimistic. It's a little tough to figure out how much is share gain. We do believe there is – that there's definitely share gain there. I can't really speak to the competition and where they're at in their cycle with their supply chains and kind of their operational model. But I can tell you, we feel really good about our ability to continue to capture market as this goes forward just given our operational model.



**Reuben Garner**

*Analyst, The Benchmark Co. LLC*

Q

And maybe a follow-up, like some of those growth initiatives that you mentioned like the inserts and electric, are you guys kind of first movers or do you have an advantage in those spaces? Are your products better and that's why you're growing faster? Do you think the whole category is seeing substantial growth in those areas as well?

**Marshall H. Bridges**

*Senior Vice President & Chief Financial Officer, HNI Corp.*

A

I think a lot of this is unique to us, Reuben. Obviously, the insert sales, that's one of our early growth initiatives, a little more mature than some of our other ones. And we're definitely seeing momentum there. The website traffic is absolutely unique to us and we're definitely driving awareness consideration efforts there. Electric fireplace is probably an emerging category. But I think we're probably doing better than most with the growth rates that Jeff mentioned earlier, up 100% year-to-date. I think it's important to note that these are all very important growth initiatives. They're not terribly large categories right now, but they're categories that can be really large as we move forward and try to grow the category and penetrate more of the remodeling activity.

**Reuben Garner**

*Analyst, The Benchmark Co. LLC*

Q

Got it. And then on the Workplace side, are you seeing the same kind of trends in small businesses versus contract in each of your geographies, in other words, in like New York and LA? Are the smaller businesses may be returning to the office faster because it's just easier to get a small office open up than it is for a big Fortune 500 company to move that quickly, or is it also – are you also benefiting from the markets where your geographical markets where you guys are stronger in some markets that have opened up there?

**Jeffrey D. Lorenger**

*Chairman, President & Chief Executive Officer, HNI Corp.*

A

Yeah. I think it's a good question. I think the – I would probably lead with the geographic locations. New York is [indiscernible] (20:35) New York is a little unique. But any major metro with mass transit is still kind of locked up even on the smaller to midsize. So, this is probably a little bit more geographic-driven based on what we look at.

**Reuben Garner**

*Analyst, The Benchmark Co. LLC*

Q

Perfect. Very helpful. I'm going to sneak one more in. You called out investments in the press release as a reason or relative to the year-ago period. Any way to quantify what – how much you're investing there, how much of it is in Building Products and some of the things that you talked about already versus maybe in Workplace? And if it's in Workplace, what sort of investments are you making there?

**Marshall H. Bridges**

*Senior Vice President & Chief Financial Officer, HNI Corp.*

A

Reuben, this is the continuation investments that we've been making for the last couple of years. We continue to add to that, ramp them up. About half of our investments are going into Residential Building Products, and the other half, Workplace Furnishings. The categories are the same. It's digital and data analytics. It's new product and efforts to grow the category on the hard side which are pretty broad. For the year, we're probably looking like \$15 million to \$20 million of incremental investments.



**Operator:** Your next question comes from the line of Kathryn Thompson with Thompson Research Group. Your line is open.

**Kathryn Ingram Thompson**

*Founding Partner & Chief Executive Officer, Thompson Research Group LLC*

Q

Hi, thank you for taking my questions today. First, focusing on your residential side of the business and with hard, with so much focus on outdoor living, could you give any color on orders or placement of your products in outdoor living spaces and have those – how have those orders trended versus kind of the more standard indoor options, really just any other way you can frame up the opportunity for the focus on outdoor living? Thank you.

**Jeffrey D. Lorenger**

*Chairman, President & Chief Executive Officer, HNI Corp.*

A

You're in residential right, Kathryn.

**Kathryn Ingram Thompson**

*Founding Partner & Chief Executive Officer, Thompson Research Group LLC*

Q

Correct. Yeah.

**Jeffrey D. Lorenger**

*Chairman, President & Chief Executive Officer, HNI Corp.*

A

Yeah. Yeah. No, it's emerging. It's a small piece of our business, but the orders are good. And that's another area that we're looking to expand in.

**Kathryn Ingram Thompson**

*Founding Partner & Chief Executive Officer, Thompson Research Group LLC*

Q

Have you sized up what that opportunity could be?

**Jeffrey D. Lorenger**

*Chairman, President & Chief Executive Officer, HNI Corp.*

A

Not really. Not totally, because it's so dynamic right now. I mean, there's a lot of focus there. So we're just trying to kind of keep up with the piece the business that we do have. But I think there's definitely a longer term play in the outdoor space that we can be – take advantage of. But we're still – we don't have a target on what on the market opportunity is just yet.

**Kathryn Ingram Thompson**

*Founding Partner & Chief Executive Officer, Thompson Research Group LLC*

Q

Okay. In your Workplace segment, or I guess the – it's good to see better relative trends sequentially improving off of the last couple of quarters. And wanted to get a little bit more into e-commerce. I mean, one, how much of the acquisition of Design Public Group, how did that help e-commerce sales specifically in the quarter? And I know that contract is lagging, but are you seeing any shift of your contract purchases going through e-commerce? And in general, just kind of how we should think and size the e-commerce opportunity given fundamental changes in a post-COVID world?

**Marshall H. Bridges**

*Senior Vice President & Chief Financial Officer, HNI Corp.*

A

Well, Kathryn, the simple answer to Design Public, we've added approximately \$6 million of revenue to the first quarter. And we're expecting to add \$40 million to \$45 million for the full year. So, we're very excited about the integration and we're seeing lots of opportunity. And it's somewhat complementary to contract. I don't know that it's a substitute, I think, that you're kind of alluding to just yet. There's still a lot of complexity in the – when you're doing a large office that makes it a little challenging to do 100% through e-commerce. But it can definitely be complementary and additive.

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**Kathryn Ingram Thompson**

*Founding Partner & Chief Executive Officer, Thompson Research Group LLC*

Q

And I guess that is kind of that – and very helpful, Marshall. I guess it speaks to the bigger change. We're seeing more complementary sort of melding versus a pure contract, but the melding of e-commerce with the traditional. And it was really just getting a better sense of how you see that in the world. Are you seeing any trends from designers more consistently splitting up borders because that's going to change your growth trajectory and how we think about modeling e-commerce going forward, if that makes sense.

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**Jeffrey D. Lorenger**

*Chairman, President & Chief Executive Officer, HNI Corp.*

A

Yeah. I know what you're getting at. I think Kathryn. We haven't really seen that yet. I think that's a rational possibility down the road. But right now we haven't seen – it's early days. I think the most that e-com we've seen is work from home kind of stand-alone as it relates to contract product, maybe going into the home.

But as far as kind of processing the two combined, I think people are still heads down trying to figure out how they want to come back to the office whether it's 50% time or 75% time and really get the main office rolling first. And then that opportunity or theory would probably come into play in kind of the later middle innings after things are kind of back up and running.

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**Kathryn Ingram Thompson**

*Founding Partner & Chief Executive Officer, Thompson Research Group LLC*

Q

Okay. And final question is on supply chain which has been a focus in the construction industry in general and also the ripple impact of the Texas freeze in the quarter. If could you give color on your basic raw materials or any new categories that are being impacted with you be it steel to – we're even hearing foam for seats has also been tough to come by because of [indiscernible] (26:59) But just being able to flesh out how you feel you are with the supply chain and the impact now and the impact you see going forward? Thank you.

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**Jeffrey D. Lorenger**

*Chairman, President & Chief Executive Officer, HNI Corp.*

A

Yes. I would. You're absolutely right. I think the supply chains for most manufacturers in a lot of categories are tight, I think, the pricing or inflation cost. But we've been able to maintain most of the categories pretty well. The foam is unique. You are correct. We have seen – we're on some allocations on foam right now. We do see that recovering. But it's been a challenge in the soft seating category, specifically in ocean freight. Then the general logistics for the supply chain has been constrained a bit as well and tight. But so far, teams have worked through it, and we've been able to maintain lead times at this point other than slight bumps in the foam area.

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**Kathryn Ingram Thompson**

*Founding Partner & Chief Executive Officer, Thompson Research Group LLC*

Q

Okay. Great. Thanks very much.

**Jeffrey D. Lorenger**

*Chairman, President & Chief Executive Officer, HNI Corp.*

A

Thank you.

**Operator:** There are no further questions at this time. I will now turn the call back to Mr. Lorenger for closing remarks.

**Jeffrey D. Lorenger**

*Chairman, President & Chief Executive Officer, HNI Corp.*

Great. Well, thanks, everybody, for your interest in HNI and thanks for joining us today. Have a great day.

**Operator:** This concludes today's conference call. You may now disconnect.

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