06-Sep-2022

Hormel Foods Corp. (HRL)

Barclays Global Consumer Staples Conference

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MANAGEMENT DISCUSSION SECTION

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All right. Welcome back. Last presentation here in this room for today, Hormel Foods Corporation, global branded food company with over $11 billion in annual revenues across 80 countries worldwide. Its brands include SKIPPY, SPAM, Hormel Natural Choice, Applegate, Justin's, WHOLLY Guacamole, Columbus Craft Meats, and Hormel Black Label, and its most recent addition, Planters.

Joining us today from Hormel are Jim Snee, Chairman of the Board, President, and CEO; as well as Jacinth Smiley, Executive Vice President and CFO. Jim Snee is the 10th President and CEO in the company's 130-year history and he joined Hormel back in 1989 in the Meat Products division. Jim was named President and Chief Operating Officer in October 2015, CEO in October 2016 and elected Chairman of the Board in October of 2017. Jacinth Smiley joined Hormel in April 2021 and currently leads all financial areas of Hormel including strategy, performance, reporting and long range business planning, as well as investor relations, treasury, tax, accounting, internal control and IT. Given the most recent announcement introducing a new operating model, well I'd like to start off with a little video and then go with in the presentation and then into Q&A. Thank you. Video?

[Video Presentation] (00:01:29-00:02:32)

James P. Snee
Chairman, President & Chief Executive Officer, Hormel Foods Corp.

Well good afternoon, everyone. Ben, thank you for that nice introduction. Thanks for joining us and Jacinth and I are excited to share a bit more with all of you about the future of Hormel Foods. And as we get started, clearly, we're going to be talking about our future. So, we'll be making some forward-looking statements, and as always, would just guide you to our 10-K and 10-Q for any additional information.

So as we think about this updated operating model that Ben was talking to you about, clearly, as we think about it, this is just a continuation of our evolution as a global branded food company. Hormel Foods has a history of

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continuing to evolve, to become a better, more agile, a more balanced organization. And if you go back in our history, pre-2013, we had a very strong focus on being meat-centric. Two primary inputs, pork and turkey, strong focus on the retail side of our business and we had a lot of commodity impact to our business.

Now, if you break that into another section, the 2013 to 2019 window, we can start to see this bigger evolution for the organization. While we started to expand beyond meat protein with the acquisition of SKIPPY peanut butter, or WHOLLY Guacamole, really our foodservice business started to hit its stride and gain traction where we saw very, very strong growth. And then most recently, from 2020 on, our focus of really becoming this global branded food company. It's a company that's more food-forward, all about the food and it's got a sharp focus on the needs of our consumers, our customers and our operators. But make no mistake about it, even through all of this, meat protein is still a very important part of what we do. And if you lay this evolution out on a timeline, you can see that we have a very strong bias for action. And so the strategic actions, really since the acquisition of SKIPPY peanut butter in 2013, it becomes readily apparent to understand how we have evolved to become this global branded food company, and this shift has involved a series of intentional and very strategic actions.

We've made a number of strategic acquisitions focused on snacking and entertaining, growing our leadership position in the foodservice channel, and also expanding our geographic footprint. We also have regular evaluations of our portfolio, which, in some cases, have led to divestitures of our business where we identified a better long-term owner. We've also been able to right size some of our input supply chain, in particular our pork supply chain with the divestiture of two hog harvest facilities and entry into a what we believe is a better for us long-term pork supply agreement.

The creation of One Supply Chain, making sure that we had a holistic view of our supply chain, so that we could operate more efficiently. And then this continued modernization of our company through technology and e-commerce capabilities. Project Orion, the Digital Experience Group are two very significant projects have served our company very, very well. So again, on this journey, on this evolution, you can see a lot of activity, a strong bias for action over the last decade.

So then our next step really is this new operating model and it's a culmination of all of these recent strategic actions that we've taken place. And our intent here is to make sure that we have an operating model that clearly supports and aligns our strategic priorities. We have very well-defined strategic priorities, and I'll highlight those here for you in a second. But we want to make sure that an operating model, again, that aligns and supports those strategic priorities is critically important to the ongoing success of our organization. Our ability to deepen our sales capabilities; we have a best-in-class sales organization across our enterprise and being able to strengthen that organization while also simplifying our approach to customers and operators is going to have a very positive effect on our business. And in today's environment, never has it been more important to be able to make better, faster, and more agile decisions; and this updated operating model will enable us to do just that.

So I talked to you a little bit about making sure that we're aligned against our strategic priorities and these are the most current set of strategic priorities that we updated at our last Investor Day. The interesting thing is, if we go back in our history, it hasn't been this revolutionary shift in strategies. It truly is evolutionary in nature, making sure that we're able to expand our leadership in the foodservice channel, thinking about our iconic and strong brands, and how we protect and grow them not only in the retail space but foodservice and internationally, making sure that we continue to grow and become a more global organization. With the acquisition of Planters last year, now making sure that we capitalize on our ability to grow and amplify our presence in the entertaining and snacking space.

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Becoming a more food-forward organization; not resting on our laurels of the products that we have but again thinking about where the consumer is going. Some of it with our ethnic portfolio that we have in our MegaMex joint venture, some of it with our Applegate brand which is talking to consumers in a new and different way, and always a focus on how do we continue to transform and modernize our organization. So this new strategic operating model will create three fully empowered segments. On the slide, it looks so simple. Obviously it's going to be a bit more complex, but bringing all of our retail businesses together. Historically, we've been a bit disparate having a retail refrigerated business, a retail grocery business, our Jennie-O retail business. But bringing them all together, the same with our foodservice business; and again our international business will be little changed in this update.

So as we go through each of them, retail will be and is our largest operating segment. It'll include so many of our iconic brands that hold the number one or number two market share in the categories in which they compete; think Planters, SPAM, SKIPPY, Columbus, Applegate, Jennie-O. Deanna Brady, who is currently the Executive Vice President of our Refrigerated Foods segment, will lead this new retail segment. And as I said, all retail sales will now be unified into a single team. This will simplify our company's approach to customers while really unlocking our company's scale in the marketplace.

And how we're going to organize within the retail segment is with these six strategic pillars, taking and thinking like our consumers. They don't think about, when they go to the store, am I going to buy a refrigerated meal or a shelf-stable meal? They're going to the store thinking I'm going to purchase a meal; and so we're going to think like the consumer and aligning around convenient meals and proteins.

When we think about entertaining and snacking, in our old model, we had parts of the business, again, that were disparate, Planters in grocery products. We had our gatherings, party trays in our deli business, Columbus in our deli business, pepperoni in our refrigerated retail. Now bringing all of this together with a singular focus on the customer, the consumer and the operator will really allow us to strategically align our business and our foodservice business.

So in the retail space, there'll be a lot of change for our retail business. There will be some change for our foodservice business. We'll continue to expand our leadership because what we're doing here is we are bringing in our Jennie-O foodservice business as well. We're doing that on the retail side of the business. We're also doing it here in foodservice. So the opportunity, again, to better leverage this incredibly strong core competency of our organization in foodservice, bringing in Jennie-O, thinking about our other differentiated capabilities, our direct selling organization, the innovation that we've been able to create, incredibly strong operator-known brands. The growth in our foodservice business has been incredibly strong. You can see the growth this year, 30%. But probably even more impressive when you factor in the effects of the pandemic, a three-year CAGR of 5%. So, again, we talked about the foodservice business very often as a distinct competency to our organization, and we firmly believe that.

So, again, some of the changes that will be happening, we'll have our core Hormel Foods. We're going to bring in the Jennie-O Turkey Store business, and then some businesses that you don't hear often about our affiliated businesses. These are more custom solutions for foodservice distributors and operators that we've housed in another part of the organization. Again, we'll now be bringing all of this under the foodservice umbrella to truly unleash the potential of this entire portfolio.

And then our International business, largely unchanged in this operating model but still an area of focus for our organization because we want to make sure that we aggressively grow and develop our global presence. We've

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got three simple go-to market strategies with exports, multinational, and some of our joint venture and royalty partnerships. That doesn't change, but it does continue to allow us to focus on this business.

So, as we head off into the future, this updated operating model really is going to allow us to better align our operating model against our strategic priorities to help us deliver the growth that we need in the future.

I'm now going to turn it over to Jacinth Smiley, who'll highlight some of the financial aspects of our business.

Jacinth C. Smiley

Executive Vice President & Chief Financial Officer, Hormel Foods Corp.

All right. Thanks, Jim. And great to be here, and great to have you all. So, as we think about these three very important segments of our business to help us drive strategic growth going forward, you think about what does that mean in terms of how do we enable that to happen. And so underneath these three segments, we have created a few different centers of excellences that I will just highlight as we go through here.

One of them is what we are calling brand fuel. And what that actually does for the organization, it houses our areas, including innovation, insights as we think about customer insights, and how do we use that to then make our decisions in terms of where do we lean into and how do we drive our products. And so, that's underneath our brand fuel, and that's a big piece of how we will continue to grow.

The other piece there is around supply chain. And supply chain, as Jim talked about, is an area that we have stood up over the past couple of years, and the One Supply Chain initiative will continue to be a critical focus for us as we bring together all the different parts of the organization, including Jennie-O, to be able to then fuel and think about a strategic end-to-end solution for the company.

Alongside all of that is the financial aspects of all of this is our capital allocation strategy, which I can inform you as being new to this seat, not something that I'm intending to change materially. So, we'll continue to focus on these three areas in these orders as we have them here. So, one, what is required for the organization. And dividend is something that's very big to us in terms of our focus, ensuring that we continue to maintain our dividend. Increasing the dividend year-over-year is something we've historically done and we intend to continue to do that. Maintenance CapEx is another area that we will continue to focus on. Year-over-year, we have historically allocated about $100 million or so. With the addition of Planters, we will continue to have about $120-plus million dedicated to maintenance CapEx. And certainly, if there is debt, we have an obligation, of course, and we're disciplined enough to pay down debt. That's not something the organization is used to having. We took on debt with Planters, the Planters acquisition. We're not really required to pay down debt until 2024. And then, of course, pension obligations.

And then as we think about the next layer that comes after what's required, our next area of capital allocation would be from a strategic perspective. So, think about M&A and acquisitions that we would do. And as we think about the six strategic priorities, our focus there is around acquisition that aligns squarely with each of those priorities that Jim has laid out for the organization, which also then must pass the screens from an investment perspective for us, and it'd definitely be accretive from a growth perspective for the company.

And then lastly would be from an opportunistic standpoint. So to the extent that we have met all the other two buckets above, and we would like to purchase shares, and that's where we would then lend the rest of our capital to repurchasing shares. But that's definitely not something that's on the radar at the moment. Our focus is clearly on the first two buckets, and we'll continue to reevaluate whether or not we would purchase shares.

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So, here are some of the data points around where we are. We definitely want to continue to be the dividend aristocrat. It's not a trend I want to break. And so, we'll continue to contribute as well into paying down the debt as I talked about in the future as necessary. At the moment, we are sitting at 1.6 times EBITDA from a debt perspective. And our intent is to continue to evaluate whether we would pay down the debt. We're at a very favorable interest rate at the moment and still within the 1.5 to 2 times debt-to-EBITDA. So, not something we're immediately thinking about, but we'll continue to evaluate that. And as we think about the CapEx going forward as I mentioned, that is an obligation that we will continue to maintain and where we continue to see a focus from a cash allocation standpoint.

As we think about the strategic priorities going forward, and where we will be from an acquisition standpoint, as I mentioned before, we have different SKUs that we will continue to look at as we look at M&A. We have invested in over $4 billion so far from an acquisition standpoint, which generated over $1.4 billion of sales. And so, as we look at our investmenta going forward from an M&A standpoint, that will continue to be top line and bottom line accretive to the company for any acquisitions that we decide that we're going to do moving forward.

Investment grade, as we do all of this, is certainly a priority for the company, and that is very important. We're very strong from a balance sheet perspective and financial. We're sitting at the moment with $850 million of cash. And so, it really puts the company in a very strong position to really be discerning about where we would really want to put our cash and what we would be interested in funding at this stage.

Our model and our algorithm is consistent with what we have shared before, and we continue to be focused on ensuring that we meet those targets. So, 2 to 3 times organic sales growth, and 5 to 7 times operating profit overall with 15% innovation. I know we haven't shown that innovation on our strategic slide. But make no mistake that something that's really core and critical to us continue to grow and meet the six strategic priorities that Jim has laid out, because without that innovation, we really will not be able to grow in the way we would like to and think about where the consumer is and continuing to lean into those consumer trends and to stay competitive and relevant to the market. So, innovation continues to be a very strong focus for the company.

And with that, I'll turn it back over to Ben.

Benjamin M. Theurer

Analyst, Barclays Corporate & Investment Bank

Perfect. Thank you very much. And obviously a lot to discuss and to dig deeper.

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QUESTION AND ANSWER SECTION

Benjamin M. Theurer
Analyst, Barclays Corporate & Investment Bank

Q

So maybe, Jim, to begin with on go-forward. At first look, change is obviously looked somewhat radical because it's a complete change of what you've had and how you've run the business in the past. But there seems to be obviously benefits to be perceived as a one Hormel by customers, be it in retail foodservice. Pretty sure you've pitched that concept to your core customers across the different channels. What were like first reactions, initial reactions, and what do you think is likely going to actually improve on the customer side but also on your side?

James P. Snee
Chairman, President & Chief Executive Officer, Hormel Foods Corp.

A

Yeah. I think there's a couple of things. The first reaction, Ben, is probably, what took you so long, right. We've had instances where we could have a Hormel salesperson, a Jennie-O salesperson and maybe an Applegate salesperson in a customer's office at the same time. And so, just making sure again that we are leveraging our scale as an organization. In many ways, some customers have already thought about that. But again, you have to rely on them to think about it. Here, we're saying, you know what; we're going to make it easy for you. And so, when we walk through the door and we're going to talk about our retail business, here's our entire retail product offering.

Now, let's talk about the consumer. Let's talk about the different categories where we compete. And we're not relying on chance or potential collaboration within our own organization. We're making it happen and creating that alignment for the customer. So, all of the feedback so far has been incredibly positive, and a level of excitement because they now have to have one meeting as well, and they know that they're going to cover the entire organization.

Benjamin M. Theurer
Analyst, Barclays Corporate & Investment Bank

Q

Okay. Perfect. Now, retail you've mentioned that it's obviously the biggest component. I think you've said that in the presentation it's where most of the change is going to happen. It's about 60% of sales. There were certain subcategories within that segment. Within those big subcategories, where do you see the biggest opportunity is? And I think you've talked about this last week and some synergy potential, $20 million, $30 million on an annual run rate. So, how should we think about this, and how faster you think you're going to get to the synergy potential.

James P. Snee
Chairman, President & Chief Executive Officer, Hormel Foods Corp.

A

Yeah. So, there's certainly – there's two parts to that, Ben, and if you remember, at the end of last year, we talked about the Jennie-O transformation that we were embarking upon, and that's really where we identified the $20 million to $30 million of cost savings. And so, this is, again, part of that evolution and where the two projects have merged together. You can see, anybody who thought Jennie-O was going away, nothing could be further from the truth, when you see the presence in retail and foodservice, just how important turkey will continue to be as part of this go-forward initiative. And so, this $20 million to $30 million cost savings is going to be relatively soon because we are as we head into 2023, bringing the retail and foodservice organization into Hormel Foods. And so, that's where the savings were identified. We're bringing that together starting in fiscal 2023.

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Benjamin M. Theurer
Analyst, Barclays Corporate & Investment Bank

Q

Okay. So, basically, now soon. Now, foodservice, you've had it on the slide. So, very strong year-to-date. And I think it was you who said 4%, 5% on a three-year CAGR. Within the different segments, in Hormel specific, where do you stand like to pre-pandemic? Are there certain areas where you're way above, in others you're still behind, so just to give a little bit of a sense of where you still have maybe some growth potential and how this go-forward potentially enable you to reach levels where you haven't reached them yet?

James P. Snee
Chairman, President & Chief Executive Officer, Hormel Foods Corp.

A

Yeah. One of the things that we've done really well within our foodservice business is, a, we've created products that help operators with their labor issues, their cost savings initiatives. But we've also been very intentional about the segments where we compete. And so, if you go back 15, 20 years, we were primarily, say, a lodging, sort of hotel business and maybe a commercial or restaurant business. Again, over the last probably decade, there's been a strong effort to focus more on healthcare, to focus more on colleges and universities. With our Jennie-O foodservice organization, very, very strong core competency in the K-12 education business. And so, as we bring that part into the overall foodservice business, again, it's just going to enhance our ability to focus on some of these segments or sub-channels within foodservice.

The other thing that it does, Ben, is as we think about what might happen with some of the macroeconomic conditions ahead of us, it really allows us to pivot the business. So, if you saw a downturn in a specific area, you might see an upturn in education or in healthcare. And we're really well-positioned to take advantage of all those opportunities.

Benjamin M. Theurer
Analyst, Barclays Corporate & Investment Bank

Q

Okay. Now, a little bit more kind of short-term question now. On guidance, you just updated last week and it was like interesting to see how you actually increased sales but lowered profit guidance like kind of a rarely seen combination, if you want to put it this way, can you elaborate a little bit on what your expectations are? What are the puts and takes for the fourth quarter and why the risks more on the downside with profits while sales is actually a risk on the upside?

James P. Snee
Chairman, President & Chief Executive Officer, Hormel Foods Corp.

A

The big change for us, there are really three things that drove that as we talked about some of the labor turnover that we're having in our facilities where big driver has been the input costs from the commodity markets that stayed much higher, much longer than we had projected. And then some significant additional warehousing costs that we've incurred that's elevated. And some of that is specific to the International business because of some of the port congestions and our inability to get product shipped out. We're now having to store that product by the port and international warehouses tend to be more expensive.

And so the other key takeaway there, as we talked about those three elements being a bit more transitory; and so we do expect to see moderation over time. Part of it, we have to get better with the turnover and the productivity and efficiency with our team members. The other two, our One Supply Chain can help us with the warehouse and then the markets are kind of the markets; and Jacinth, I don't know if you'd add anything there.

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Jacinth C. Smiley
Executive Vice President & Chief Financial Officer, Hormel Foods Corp.

A

The only piece I'd add is, there is definitely pieces to it that will be overall change going forward that we're trying to, again, mitigate with some of the work. And I didn't touch on it here from a One Supply Chain standpoint. Automation and simplification and really just process optimization that we're working through, that will definitely help with some of the margin pressure that you've seen there.

Benjamin M. Theurer
Analyst, Barclays Corporate & Investment Bank

Q

Yeah. And now pricing obviously is still very strong. Elasticity is surprisingly low. We've seen this based on a year-to-date basis. To what extent do you attribute the relative strength on like still getting the volume sold even with the prices you've been doing? I think SKIPPY was one of the examples you've highlighted in earnings, but just being able to actually provide products, overcome certain supply chain issues versus peers or is it that consumers are still not feeling the challenges from ability perspective and from the spending willingness potential; and how does that feel for next year?

James P. Snee
Chairman, President & Chief Executive Officer, Hormel Foods Corp.

A

Yeah. I would say at this moment it probably feels like a little of both. There still seems to be a very strong consumer, they're willing to spend not only in the retail space but, the strength of our foodservice business would indicate that. From an elasticity perspective, there still are improvements in fill rates that are coming. The other part is there's different varieties that maybe went by the wayside during the pandemic as you focused on high volume items to make sure there was product on the shelf. And so we're still improving fill rates. We're still working on getting some of those varieties back on the shelf; and so to get a really good, clear read on elasticities feels like we're still a little bit away from that.

Benjamin M. Theurer
Analyst, Barclays Corporate & Investment Bank

Q

Thank you. Now, avian influenza and the impact on Jennie-O, we've seen obviously volatility volume now came down. The profits were really, really strong; more than 500% up in the quarter. How do you think this is going to carry over into next year, where the opportunities may be for you to gain back as you kind of get away with lower levels of cases; and what are the risks on the downside, maybe?

James P. Snee
Chairman, President & Chief Executive Officer, Hormel Foods Corp.

A

Yeah. I think – the first thing is we've got to make sure that there's a stabilization of the cases. So, once we can have AI moderate on a longer-term basis, we'll be able to see that repopulation in the supply chain, which of course will provide more volume through the entire network. So in addition to the Jennie-O business, there's a lot of meat that goes into our refrigerated food segment, both retail and foodservice that's being sold and so that will be an opportunity as we have more meat coming into the system. Like anything, we're dealing with record high fresh meat prices at $6.50 a pound. That obviously was something that we had not planned on the scene. And so, how does that impact the consumer over time?

It's obviously going to have an impact on pricing. And as we move into to 2023, what does that market do? How does that flow through to pricing and how does the consumer react to that, I think are some of the things that we're watching very, very closely because not only just in Jennie-O, but in all of our businesses, when it comes to pricing, we know that we have a responsibility to the customer, the consumer and the category. You've heard us

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say that many times, but we want to make sure that we make responsible decisions for the long-term health of the business.

Benjamin M. Theurer
Analyst, Barclays Corporate & Investment Bank

Q

Okay. Actually, one last question on within the capital allocation and what you've talked about, obviously, the preferences are clear here. But can you share maybe a few examples of what we should expect in terms of like investment into growth? Where do you feel there is a need to invest into growth, is it greenfield, brownfield capacity expansion; which segment, where do you feel like the need to invest?

Jacinth C. Smiley
Executive Vice President & Chief Financial Officer, Hormel Foods Corp.

A

I think it's all of those.

Benjamin M. Theurer
Analyst, Barclays Corporate & Investment Bank

Q

Okay.

Jacinth C. Smiley
Executive Vice President & Chief Financial Officer, Hormel Foods Corp.

A

But as I think about the six strategic priorities and the different areas that we're looking to grow, we're going to need to invest in all of those spots. I think international, there isn't any way for us to really grow international the way we need to grow it without actually perhaps doing some M&A that could be perhaps a joint venture, different kind of partnerships in the different spaces. We're currently focused on China, Brazil, wanting to be a leader in foodservice. In order to do that, there is a combination where we already made investments in greenfield and expanding in places like in our Omaha facility, right, for Papillion or Pepperoni and different areas, but then to grow in a bigger way, we may have to make acquisitions in that space. So I would see us doing really a combination of all of these organic and inorganic and definitely inorganic in those strategic places that we have really laid out.

Benjamin M. Theurer
Analyst, Barclays Corporate & Investment Bank

Thank you. Perfect. Well, Jacinth, Jim, thank you very much for coming, having been here. And well, that's it for today. There is no breakout just as you know, there is no ability for breakout today. But you all had, I think, opportunities to meet with management. So thank you very much and have a lovely afternoon.

James P. Snee
Chairman, President & Chief Executive Officer, Hormel Foods Corp.

Great. Thanks, Ben.

Jacinth C. Smiley
Executive Vice President & Chief Financial Officer, Hormel Foods Corp.

Okay. Thank you.

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Benjamin M. Theurer

Analyst, Barclays Corporate & Investment Bank

Thank you all.

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