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Haypp Group AB (HAYPP.SE)

Q2 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Welcome to the Haypp Group Q2 Report 2023. For the first part of the conference call, the participants will be in listen-only mode. [Operator Instructions]

Now, I will hand the conference over to the speaker CEO, Gavin O'Dowd and CFO, Peter Deli. Please go ahead.

Gavin O'Dowd

Chief Executive Officer, Haypp Group AB

Thank you very much. Thank you. Good morning, everybody, and welcome to Haypp Group's presentation, our interim report for the second quarter of 2023. Today, we will briefly walk you through an overview of our business and comment on the operational and financial performance for the second quarter.

The interim report and the results presentation is available at the Investor Relations section of our corporate website. Presenting today, in addition to myself is, Peter Deli, our new CFO. During Q2 Svante Andersson, our previous CFO moved to a new role of Chief Operating Officer in the company.

With that, I would like to pass over to Peter to introduce himself.

Peter Deli

Chief Financial Officer, Haypp Group AB

Good morning, everyone. It's a great pleasure to be here and support Haypp Group to achieve its long-term goals. By the way of introduction, I'm working for Haypp Group since 2020. While Gavin and Svante [ph] was busy with the (01:27) IPO, I guided the business to achieve its financial objectives. [indiscernible] (01:36) substantial amount [indiscernible] (01:37) during my seven years with BAT, while prior to which, I worked for AmRest in a retail environment where consumer focus and margin management was essential.

What you can expect from me is, therefore, I will ensure that we keep the right balance between profitability and growth. We will keep investing in a smart way, while I will emphasize cash generation.

With that, I give it back to Gavin.

Gavin O'Dowd

Chief Executive Officer, Haypp Group AB

Thank you, Peter. Moving to slide 4 in our results presentation, [ph] here we see it our (02:10) higher purpose of inspiring healthier enjoyment to millions, which is predominantly moving people from cigarettes to safer alternatives, which was traditionally snus, but in more recent years has been nicotine pouches.

On slide 5, we have a chart presenting a spectrum of nicotine products on the relative level of harm versus cigarettes. Haypp Group's primary focus on nicotine pouches and snus, lies at the lower end of the spectrum. The scientific body of research around modern harm reduced alternatives, cigarettes has come a long way in recent years. In addition to nicotine pouches and snus, products such as tobacco-heated devices and vapour are widely accepted as carrying a significantly lower level of harm than traditional cigarettes and other tobacco smoking products.

On slide 6, we can see what smoking rates are like across a range of European countries. Sweden at a strong tradition of oral nicotine and robust harm reduction strategy is below one-third of the European average of smoking rates and is on track to become the first smoke-free country. In Norway, oral nicotine products were introduced some 20 years ago. Smoking rates [ph] are at (03:20) similarly low level at three.

On the right-hand side, we can see how smoking rates collapsed between 2005 and 2020 in Norway, especially, among the younger part of the population. And it is almost perfectly correlated between that and the uptake of nicotine pouches and snus among the same age groups. It is this impact on public health which we wish to bring to other countries.

Turning to slide 7. We can see the outlook for the market, which we laid out in 2021 in connection with our IPO and we believe it is equally valid today. We see a global market size for nicotine pouches and snus which will increase from SEK 27 billion in 2020 to SEK 60 billion in 2025. All of this growth is going to be driven by nicotine pouches, which will increase from a share of the market of 30% in 2020 to 80% in 2025.

Since this market outlook was prepared, nicotine pouches has been tracking in line with the expected [ph] tracker (04:15). The category is now growing faster than initially expected. Haypp Group is growing significantly faster than the category in each individual market. The primary driver behind the growth of the category is strong consumer demand for less harmful products, which is greatly supported by regulators in general, adopting the principle of harm reduction [indiscernible] (04:39) approach to nicotine products.

This in turn, has led to a significant investment in the category from other industry players, both large tobacco companies and [indiscernible] (04:49) new entrants who are driving innovation. Furthermore, the category is very well suited for online, and we see online penetration rates increasing for every quarter that goes by and we expect online to increase at healthy levels.

Moving along to slide 8. You will see an overview of our logistics infrastructure. Convenience remains one of our key USPs and the ability to offer our customers across all markets. Fast and reliable delivery sets us apart. We completed the second phase of our warehouse expansion plan in Q2 of last year and we're now operating six warehouse locations across our core and growth markets.

We have managed this expansion [indiscernible] (05:30) continuing to maintain healthy inventory turnover of 15 tonnes. Furthermore, the warehouse expansion has led to a further improvement in customer retention rates as the convenience levels have increased.

During Q3 of this year, we plan to open our own warehouse in Milton Keynes, which is just north of London. We also plan to refurbish our Stockholm Warehouse in Q4 to facilitate future growth. In addition, we are progressing to another phase where we are enhancing our infrastructure and our backend. In addition to supporting scale of a future growth in our current categories, it would also enable us to efficiently move into new categories [indiscernible] (06:10) new markets and adjacent categories.

Moving along to the operational highlights for Q2 on slide 10 and starting on our performance in nicotine pouches. The growth in consumer demand for significantly less harmful nicotine products remained strong in Q2. All growth for the combined nicotine pouch and snus category is coming from nicotine pouches.

With this in mind, nicotine pouch volume is our primary measure of growth. In addition to the general nicotine pouch growth – category growth, Haypp continues to grow market share across all of our markets. Our nicotine pouch volume increased by 35% year-on-year for the group, driven by solid growth across all our geographies. We are delighted to say that nicotine pouches are now more than half of our volume for the first time ever.

We continue to play a pivotal role in launching products in the nicotine pouch category, which in turn accelerates the migration from cigarettes. During Q2, over 20% of our nicotine pouch volume relates to products which were launched in the past year.

As I briefly mentioned earlier, our investment in logistics infrastructure in the second half of 2022 have resulted in material improvements and customer satisfaction and retention rates. In a difficult macroeconomic environment, for our customers, we are particularly pleased to note that we are growing our active customer base by 18%, indicating that our value proposition remains highly relevant, even in challenging economic times.

On slide 11, we will look at some of the regulatory updates. The Norwegian parliament voted in the beginning of June in favour of a new national tobacco strategy. The public health strategy comprises of measures within most of the priority focus areas for the Norwegian health policy and is renewed every four years and includes a national strategy for the tobacco control.

The proposed measures should be seen as a gross list of efforts and based on previous input from different health organizations. The publicized measures is not a legislative proposal, but a formulation in the strategy, with the aim to prevent minors from gaining access to tobacco products and based on previous public health strategies, it's clear that far from all of these desired measures are being realized.

While we share the government's view that the issues addressed in the public health strategy, we do see that domestic online channel is already being fully committed to preventing youth access to nicotine products through robust and modern age verification processes. Our own age verification process has a zero failure rate in preventing underage buying from our e-commerce stores, which is unheard of in any age verification measures in physical stores. Hence, a ban on domestic e-commerce is unlikely to be part of the solution for youth prevention.

It was clear during the Norwegian parliamentary hearing that the majority of members did not support an online ban. On the back of this, we remain confident that the legislation will continue to support domestic online sales.

In addition, on the 30th of June, Sweden introduced more rigorous product standards for nicotine pouches. We welcome this legislation, which brings the rest of the Swedish market broadly in line with Haypp Group's own internal product standards.

With that, I'll pass the word over to Peter for comments on the financial performance.

Peter Deli

Chief Financial Officer, Haypp Group AB

Thank you, Gavin. [indiscernible] (09:50) page 12 and a financial review for the group. In Q2, we reported a net sales increase of 23% in the second quarter. In constant currency, net sales increased also by 23%. Effectively, all of our growth is attributable to a progress with the nicotine pouches and we are recording solid growth rates for nicotine pouches across all markets while tobacco based sales revenue is only growing low-single digit.

The gross margin improved year-on-year by 0.4 percentage points to 12.9%. We continue to further strengthen our position in the value chain within the category, which [indiscernible] (10:31) operation, we'll continue to drive our gross margin performance over time.

Adjusted EBIT for the quarter grew by 40% versus last year and amounted to SEK 20.4 million, which corresponds to an adjusted EBIT margin of 2.7%, up by 0.4 percentage points versus last year. The drivers behind the EBIT margin uplift is higher volume and gross margin partially offset by higher adjusted OpEx from investment in the organization to support further growth. Cash flow from the operating activities during the period amounted to SEK 130 million.

Going to page 13, where you see an overview of our core markets. Reported net sales for the segments grew by [indiscernible] (11:20) during the quarter and amounted to SEK 587 million. In constant currency, net sales increased by 14%. Sweden nicotine pouches continue to perform well while the market decline in snus consumption, partly driven by migration to nicotine pouches has negatively impacted the overall performance of the market.

In Norway, we are very pleased to note that net sales continues to [ph] increase at capacity levels (11:50). Our nicotine pouch volume in the core market grew 25% with both Sweden and Norway showing strong performance. Our snus volume declined in Sweden less than the market while in Norway, it achieves a low-single digit growth.

Looking at the profitability, our core markets remains strong. On [indiscernible] (12:10) basis, we have generated SEK 185 million of EBITDA in our core markets. The EBITDA margin was 7.7% in the second quarter, 0.6 percentage points down versus last year. The margin reduction in the quarter is attributable to insights revenue [indiscernible] (12:30).

We always looked at insights as a strategic important element of our business. The demand from our business partners for insights has become more strategic in nature. These projects are often completed over a longer timeframe and recorded when completed. During Q2, we have several projects underway, but not completed. We will finish these projects in Q3.

Now, let me move to our growth markets on page 14. Reported net sales increased by 78% to SEK 182 million for the second quarter and in constant currency, net sales increased by 70%. We had a strong performance, particularly in the US and UK and we see continuous acceleration [indiscernible] (13:18).

Our nicotine pouch volume in the growth markets increased by 55% in the quarter. EBITDA amounted to a negative SEK 12 million versus negative SEK 18.5 million during the same period of last year. The improvement is driven by volume growth [ph] unlocking economies of scale (13:36).

On page 15, instead of just looking at the last quarter, I would like to illustrate our performance over the last six quarters. The graphs are showing what quarter-over-quarter sales growth in percentage broken down by the key elements of it. Organic performance, acquisitions and foreign exchange impact.

[ph] As we talked about (14:03) until the end of Q3 last year, the group sales performance was [indiscernible] (14:09), however, starting with Q4 2022, our sales growth recovered.

In 2023, we grew more than 20% in both [indiscernible] (14:19) and this is also fully driven by organic performance. Core market sales remain robust despite all substantial [ph] challenge here (14:25). We are extremely happy about our growth markets, where sales growth accelerating and reached 70% in constant currency in Q2.

Now, turning to page 16, I would like us to focus on the adjusted EBITDA trajectory for growth markets. We were and we always be committed to support the growth of these markets. However, with the gradual improvement quarter-over-quarter, we believe that we are only a few quarters away to achieve profitability in this business segment.

On page 17, we have our selected KPIs. We achieved a 6% increase in our average order value, while our average order size remained constant. I would like to focus on this slide more on the balance sheet in particular. Our financial position remains strong, because the quarter with the net working capital portion of SEK 157 million out of which our inventory accounted for SEK 149 million.

Excess inventory [indiscernible] (15:36) ahead of the excise tax increase in Norway was successfully [indiscernible] (15:40) during the quarter. The fast moving nature of our product, naturally implies high inventory turnover rates and [indiscernible] (15:47) opportunities for inventory loading as they arise going forward. Net debt increased SEK 110 million corresponding to a net debt to adjusted EBITDA ratio of 0.9%, whereas 1.8 times in full year 2022.

With that, I hand the word back to Gavin.

Gavin O'Dowd

Chief Executive Officer, Haypp Group AB

On slide 19, we reiterate our long-term targets of SEK 5 billion in net sales by 2025. We also reiterate our profit target of high-single digit adjusted EBIT over the medium to long-term. As you will have seen from Peter's materials, we are already rapidly closing on this target in the core markets. And as you've also seen, the growth markets are rapidly moving to profitability and we expect them to be net contributors in a few quarters time.

Due to the growth potential in the category, the board does not intend to issue any dividends in the foreseeable future and instead utilize our strong cash position and robust balance sheet to accelerate growth.

On slide 20, we highlight the potential which we see for the overall economy growth and also the potential for online to take larger share of this category. Given how suitable the characteristics of the category are for online, we also reiterate our market leading positions in all of our key markets.

Moving along to slide 21 on our recording trading. The market trends for harm reduced products remains favorable and we continue the transition of the business [indiscernible] (17:20) mainly driven by the nicotine pouch category. On top of that, the online channel continues to grow relevance in the category. In terms of inflationary pressures on inbound costs, we reiterate our previous guidance that inflationary pressure on our cost base remains limited.

Given the non-cyclical characteristics of the category, we remain confident that any inflationary pressure can be passed on. Looking ahead, the increase in growth rates, which we saw in Q2, has accelerated at the start of Q3. This we need to be conscious that this could be at least in part driven by favorable weather conditions. We've recognize that a significant number of nicotine pouch users in the UK were or potentially still are vapours.

The broader portfolio, not only gets [ph] us a foothold (18:14) in the vape category, but helps our customers to migrate to nicotine pouches. Our capabilities to attract new customers and retain them [indiscernible] (18:23) offering hinge around convenience, assortment and price continues to perform well in the current macroeconomic environment. We are on track with our plans to enhance our digital infrastructure, including our backend, enabling further growth opportunities, both in terms of new geographies and new categories in addition to releasing benefits of scale.

Lastly, we're very well positioned in the current complex economic environment for consumers with a strong balance sheet and a non-cyclical product and the capital light business model. We remain highly flexible and to strengthen our market positions.

As a wrap-up, I would like to guide you to slide 22. There's more than 1 billion smokers in the world, the majority of whom are looking for healthy alternatives, and nicotine pouches is the fastest growing category. The category is perfect for online, and we are in an undisputed global online market leader where we have over 10 times the size of our nearest competitor.

We have a symbiotic relationship with our suppliers. In addition to being the partner of choice for new launches, we are also the largest provider of consumer insights. We continue to welcome proportionate regulation and we often benefit from us. And our unit economics continues to improve as we scale. We have a highly engaged team with core competencies across both nicotine industry and e-commerce.

Before I hand over to the operator for questions, I would like to invite you to our Capital Markets Day in November in Stockholm.

Operator? Now, I would like to open the line for questions, please.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] The next question comes from Niklas Ekman from Carnegie. Please go ahead.

Niklas Ekman

Analyst, Carnegie Investment Bank AB

Q

Thank you. Just a couple of questions from my end. Firstly, you could elaborate a little bit more on the regulatory situation in Norway. What do you think is the most likely process in the coming months or quarters? How lengthy a process do you expect this to be before we get some clarity on what the Parliament's intentions are for this, the proposed online ban?

Gavin O'Dowd

Chief Executive Officer, Haypp Group AB

A

Absolutely. Good morning, Niklas. And so, I guess, just to give a little bit more background within that regulatory space, the initial concern that hinged around some of this within Norway was a slightly broader aspect than online sales. It hinged a lot around digital marketing, such as TikTok, and it also hinged on the basis of some illegal products being sold cross-border online into Norway.

So our understanding is that the Norwegian regulations are becoming much more familiar with the real problems that they're dealing with at this point in time and that they're starting to recognize to differentiate, for want of a better term, perhaps the goats from the sheep a little bit on this space and determine where this fundamental problems are within this category.

So as we were identifying that, it could alter the timeframe a little bit on how long it takes for this to come through. There is different ways that this can be brought back and can be brought into legislation from here. And it's difficult at this stage to determine exactly which path they're likely to go on. But we envisage that we would probably know a lot more in the latter part of this year.

Niklas Ekman

Analyst, Carnegie Investment Bank AB

Q

Very clear. Thank you. And then, can you just repeat, I didn't quite catch you talked about in the Nordics the growth rate, what was the difference between Sweden and Norway in this quarter?

Gavin O'Dowd

Chief Executive Officer, Haypp Group AB

A

Yeah. So we saw very strong performance in both markets over this quarter. Of course, Norway itself had come from some more difficult times back in late 2021 and early 2022 and we see it returning back towards normalized growth and we don't break out the markets specifically. But what we can say is, there's not a fundamental difference in the growth rates across both markets [indiscernible] (22:33) across both markets entirely.

Niklas Ekman

Analyst, Carnegie Investment Bank AB

Q

Okay. Okay. Fair enough. On your growth targets, this SEK 5 billion in sales by 2025. I think from here that requires a growth rate of 25% over the next 2.5 years, which is a lot more than you've achieved in previous quarters. And now, of course, growth has accelerated in Q1, Q2 and you talk about a further acceleration in Q3.

Do you think it's feasible for growth rates to stay around or to accelerate and stay around 25% in the next two and a half years? Is growth in growth markets expected to be strong enough to keep a growth rate at that level?

Gavin O'Dowd

Chief Executive Officer, Haypp Group AB

A

Perhaps maybe to give a little bit of context around this, what we have seen when it comes to the overall category in general, that of course, the category is getting in towards substantial share of nicotine – sorry, and I'm talking about nicotine pouches here [indiscernible] (23:33) substantial share of the overall oral category for within Scandinavia.

However, what we see is the nicotine pouch category is accelerating in the growth markets and particularly within the US, where we see the category showing very robust growth [indiscernible] (23:50) slowing down a little bit during 2021 and 2022 for which some very strong performance market wide over the last two to three quarters which continue to accelerate.

So I feel as though there's a very strong tailwind around the overall category. And of course, we continue to see growth of online as a share of the markets across each of these markets. So we feel as though a lot of the dynamics for robust growth going forward are very much in favor.

Niklas Ekman

Analyst, Carnegie Investment Bank AB

Q

Good. And can you tell us roughly what the online penetration of nicotine pouches is in the US? Do you have a rough estimates of what that could be?

Gavin O'Dowd

Chief Executive Officer, Haypp Group AB

A

The definition of online and US, I guess, is a little bit – it's a little bit skewed, but if we take a – because there are some cross-border sales going into the US via sort of a grey market here along the way. But if we take a look at the domestic market, we envisage that online is operating somewhere between 3% and 4% of the online market at this point in time. And we are by far the largest player within the domestic – within the entire US market.

Niklas Ekman

Analyst, Carnegie Investment Bank AB

Q

Thank you.

Gavin O'Dowd

Chief Executive Officer, Haypp Group AB

A

So we see strong growth potential within it.

Niklas Ekman

Analyst, Carnegie Investment Bank AB

Q

Very clear.

Gavin O'Dowd

Chief Executive Officer, Haypp Group AB

A

And perhaps it's also worth highlighting, Niklas, maybe just connecting that point back to the previous question, which you'd asked. I think, it's perhaps also worth noting that as we see a growth in the category, there's often a delay factor between people moving into the category and people moving online. So we feel as though that's sort of positive progress that we've seen in the category over the last two to three quarters we envisage will inevitably spill over into online as people become more familiar with the category and alternative ways of [indiscernible] (25:44)

Niklas Ekman

Analyst, Carnegie Investment Bank AB

Q

Very clear, thank you. And just a final question. [ph] You talked here (25:50) about profitability in the growth markets might only be a few quarters away. Does that comment include potential expansion into new markets? Do you think that you will be EBITDA positive, even including a potential acceleration of your rollout?

Gavin O'Dowd

Chief Executive Officer, Haypp Group AB

A

No. This is very much hinged on the existing markets [indiscernible] (26:11). And we take the opportunity in November when we do the Capital Markets Day to give a little bit more color on what our expansion plans will be going forward.

Niklas Ekman

Analyst, Carnegie Investment Bank AB

Q

Fair enough. Thank you so much for taking my question.

Gavin O'Dowd

Chief Executive Officer, Haypp Group AB

A

Thank you, Niklas.

Operator: The next question comes from Andreas Lundberg from SEB. Please go ahead.

Andreas Lundberg

Analyst, Skandinaviska Enskilda Banken AB (Broker)

Q

Thank you. Can you hear me?

Gavin O'Dowd

Chief Executive Officer, Haypp Group AB

A

Absolutely, good morning, Andreas. How are you?

Andreas Lundberg

Analyst, Skandinaviska Enskilda Banken AB (Broker)

Q

Cool. Good morning, Gavin, I'm good, thank you. Just a few ones here. You talk about some investments both to make sure you can move into new markets, new categories, and so forth. What does this mean on your investments or costs going forward here?

Gavin O'Dowd

Chief Executive Officer, Haypp Group AB

A

Yes. So what we're doing is, we're very much ramping up our backend infrastructure, our ERP systems and our transport administration, our APIs, connecting all of our systems together, our warehouse management systems, et cetera. So we are grouping all together here to be able [indiscernible] (27:22) be much more stable as it goes forward.

And when it comes to our cost base over the medium term, one of the benefits we see with this is that the business becomes much more scalable and becomes much more efficient as we go across multiple categories and multiple markets. So over the longer run, we think this will have quite a positive impact on our operating margins.

I guess, the other question perhaps I can get here is, what does it mean regarding our CapEx? And I think, when it comes to our CapEx, we remain committed to the 1.5%, 2% guidance that we gave as a percentage of sales over the longer term. However, we would also like to highlight that there will be – this is not a flat piece, there will be quarters which is significantly above and quarters which are significantly below.

For example, you can see in Q1 and Q2 [ph] and second year, if you see a different bidder (28:16). You see in Q1 and Q2 that we have been coming in at the lower end of that range and it will inevitably [indiscernible] (28:22) coming in at the upper end of that range or even above that range. But we remain committed to the guidance that we gave over the medium to long-term on that space. [indiscernible] (28:33).

Andreas Lundberg

Analyst, Skandinaviska Enskilda Banken AB (Broker)

Q

Cool. And on the cost side, or the P&L lumpy...

Gavin O'Dowd

Chief Executive Officer, Haypp Group AB

A

On P&L side, I don't think it will have a negative impact over the short-term, short to medium term and I believe we will have a beneficial impact over the medium to long-term.

Andreas Lundberg

Analyst, Skandinaviska Enskilda Banken AB (Broker)

Q

Got it. And when you talk about adjacent categories, what could we expect or...?

Gavin O'Dowd

Chief Executive Officer, Haypp Group AB

A

Well, we remain committed to our vision of harm reduction. So we will only work with any products which we can confirm are below 5% the harm of a cigarette and are very constructive in moving smokers away from cigarettes into the space. And this is part of the reason why we have piloted this vape category in the UK at the beginning of this year and when we extended that pilot across to Sweden on one of our stores in the beginning of the summer of this year.

Andreas Lundberg

Analyst, Skandinaviska Enskilda Banken AB (Broker)

Q

Cool. And lastly on this, you took a one-time cost for the warrant program SEK 14 million, I think it was, what program will start, and when is the next program due? Thank you.

Gavin O'Dowd

Chief Executive Officer, Haypp Group AB

A

Yes. So this program was a bit of a tidy up on a few aspects around the IPO. So it was a program that we released in the AGM in the second quarter of 2023. And because of some historical factors, there was a need to do a tidy up [indiscernible] (30:10) and hence, we took this one as a one-off, however, we don't necessarily envisage that this is something which would be done on a recurring basis.

Andreas Lundberg

Analyst, Skandinaviska Enskilda Banken AB (Broker)

Q

Okay. Thank you so much.

Gavin O'Dowd

Chief Executive Officer, Haypp Group AB

A

Thank you, Andreas.

Operator: There are no more questions at this time. So I hand the conference back to the speakers for any closing comments.

Gavin O'Dowd

Chief Executive Officer, Haypp Group AB

Thank you all very much for your time today. Greatly appreciate it. We look forward to speaking to you for the update at the end of our Q3 results in early November. And soon after that, we will be following it up with the Capital Markets Day on the 23rd of November, to which everybody would be more than welcome. We will be here in Stockholm. Thank you very much.

Peter Deli

Chief Financial Officer, Haypp Group AB

Thank you very much.

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