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Valmont Industries, Inc. (VMI)

Q4 2022 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Greetings, and welcome to the Valmont Industries Inc. Fourth Quarter and Full-Year 2022 Earnings Conference Call. At this time, all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation. We ask that you please limit yourself to one question and one brief follow-up question and return to the queue. [Operator Instructions] Please note that this conference is being recorded.

I will now turn the conference over to your host, Renee Campbell, Senior Vice President, Investor Relations and Treasurer. Ms. Campbell, you may begin.

Renee L. Campbell

Senior Vice President-Investor Relations & Treasurer, Valmont Industries, Inc.

Thank you and good morning. Welcome to Valmont Industries fourth quarter and full-year 2022 earnings call. With me today are Steve Kaniewski, President and Chief Executive Officer; Avner Applbaum, Executive Vice President and Chief Financial Officer; and Gene Padgett, who joined Valmont as Senior Vice President and Chief Accounting Officer this past October.

This morning, Steve will provide a brief summary of our fourth quarter and full-year results, commenting on our markets and long-term business strategy. Avner will review our financial performance and provide our current outlook and indications for 2023, with closing remarks from Steve. This will be followed by Q&A.

A live webcast of the presentation will accompany today's call and is available for download from the webcast or on the Investors page at valmont.com. A replay will be available on our website later this morning. Please note that this call is subject to our disclosure on forward-looking statements, which applies to today's discussion, is outlined on slide 2 of the presentation and will be read in full at the end of today's call.

I would now like to turn the call over to our President and Chief Executive Officer, Steve Kaniewski.

Stephen G. Kaniewski*President, Chief Executive Officer & Director, Valmont Industries, Inc.*

Thank you, Renee. Good morning, everyone, and thank you for joining us. Our fourth quarter was a great finish to what has been one of the best years in Valmont's history. I'm very pleased with our tremendous performance in delivering a record year of sales and profitability as we improve margins and achieve key milestones across our businesses. It is certainly a great time to be a part of Valmont.

During our discussion this morning, we will mention many factors that contributed to our results. At the very top of that list is our global team of more than 11,000 employees. I want to deeply thank them for their hard work and dedication throughout this volatile year. Notably, our production teams around the world worked tirelessly in the face of supply chain challenges and the effects of lingering COVID restrictions. They persevered and performed vital work day-after-day to ensure we continued serving our customers.

I truly believe that our global Valmont team is the most important factor contributing to our outstanding results. In addition, we have a business model rooted in our core values and focused intensely on areas that create value. This differentiated approach drives operational excellence across the organization and provides a level of resiliency that enables us to better navigate a challenging environment.

It's also necessary to have an optimal organizational structure to help us reach our potential. This past year, we realigned our business segments from four to two, Infrastructure and Agriculture. This is more than a change in how we report results. It's an organizational strategy to drive efficient capital and resource allocation across the company. It also supports our goal to institute a culture of positive change by fostering collaboration, encouraging enterprise-wide innovation, and leveraging technology to advance productivity and accelerate business growth.

In addition, as noted in the press release, during the fourth quarter we announced and completed the divestiture of the offshore wind energy structures business, Valmont SM, which has been reported in the renewable energy product line in the Infrastructure segment and is now reported as Other.

This past year, we benefited from robust end-market demand even in the face of challenging macroeconomic conditions, including higher inflation and labor constraints. As we have mentioned in the past, our strategy is to intentionally grow our business in markets with long-term drivers that are supported by multiyear demand and growth trends. The resiliency of these end markets, coupled with our focus on operational excellence and serving our customers, contributed to our fourth quarter performance and will continue to propel our business forward.

Now, let me move to a brief fourth quarter overview summarized on slide 5. Record fourth quarter sales of \$1.1 billion grew 17.5%, driven by sustainable pricing and mid-single-digit volume growth, resulting in the ninth consecutive quarter of double-digit year-over-year sales growth.

Moving to the segments, Infrastructure sales of \$771.3 million grew 15% year-over-year with double-digit sales growth across all product lines, led by strong underlying market demand and favorable pricing. We believe the broad Infrastructure build-out accelerating around the world is a multiyear event that will continue at least over the next three- to five-year period. We are seeing demand across our infrastructure portfolio being driven by the benefit of broad-based stimulus programs, continued 5G build-outs and densification efforts, and the energy transition to renewables.

Utilities, developers and governments around the world continue to deploy an increasing amount of capital on infrastructure hardening and resiliency initiatives, as evidenced by the current lead times for our large

transmission structures, which have extended to more than 40 weeks. As such, we are continuing to make strategic investments in capacity and technology solutions to meet customer demand.

Moving to Agriculture, sales of \$335.1 million grew 21.1% year-over-year, led by sustained pricing and volume growth, primarily driven by market strength in North America and Brazil. Farmer sentiment remains positive, supported by net farm income expected to exceed \$160 billion for 2022, nearly 14% higher than 2021's record. 2023 net farm income levels are projected to remain elevated, and certain core input costs such as fertilizer, fuel and pesticides are expected to stabilize or potentially decline.

In addition, the long-term market drivers of water conservation, global population growth and ongoing food security concerns are supporting solid demand globally, encouraging irrigation and technology investments. These strong ag market fundamentals are also contributing to our robust international project pipeline, as evidenced by the new projects in Africa that we announced last month, which I will speak more about in a few minutes.

Severe drought conditions are persisting across many key global markets, putting pressure on crop yields and expected stock levels, keeping global commodity prices above historical norms. We expect all of these market drivers to continue throughout 2023. Finally, as reported in Other, offshore wind energy structure sales of \$33.3 million grew 44.1% year-over-year. As mentioned, the divestiture of this business was completed at the end of 2022.

Turning to the full-year summary on slide 6, sales grew 24.1% year-over-year to a record \$4.3 billion, driven by deliberate pricing strategies, strong markets across our businesses and focused execution by our teams. We achieved considerable growth across the portfolio and successfully added incremental volume within our existing facilities through strategic capacity expansions, improved operational efficiencies and lean methodologies, while successfully navigating through difficult labor market constraints and lingering pandemic impacts earlier in the year.

Turning to the segments, Infrastructure sales grew 23.5% year-over-year to a record \$2.9 billion, with strong sales growth across all product lines. In Agriculture, sales grew 31.3% year-over-year to a record \$1.3 billion with strong sales globally, including another record year of sales in Brazil. Agriculture Technology sales grew 17.6% to \$115 million, in line with our expectations.

In 2022, we focused heavily on integrating the Prospera Technologies team with our market-leading irrigation and agronomy team services. I am very pleased with the progress towards our strategy to provide growers with technology solutions that make the farm more efficient and increase land productivity, while improving sustainability and reducing input costs.

Turning to slide 7, I'd like to take a few minutes to highlight an example of how sustainability is ingrained in the fundamentals of our Agriculture business. The number of people suffering from food insecurity around the world has been rising due to the pandemic and geopolitical tensions. We partner with countries to increase their local food production, which reduces their dependence on grain imports and creates self-sufficiency in supplying food to their growing populations.

Supporting our agriculture growth strategies and the UN Sustainable Development Goal of Zero Hunger, we continue to expand our international irrigation presence. Last month, we secured an \$85 million order for multiple projects in Africa. These projects will supply the region with irrigation equipment and advanced technology solutions to help meet the escalating demand for increased land productivity and reliable food production.

Utilizing our industry-leading technologies that provide remote monitoring and controls, together, these projects will become one of the largest installations in the world of connected pivots, enabling our customer to maximize crop yields while reducing input costs. Our international project pipeline is supported by growing demand across many regions for irrigation technology and ag solar solutions, as well as our global operations team and local dealer presence.

In summary, we achieved another great quarter and 2022 was another great year. End-market demand for our Infrastructure and Agriculture solutions looks to be positive well into 2023, and we entered the year with great momentum and confidence.

Before I turn the call over to Avner, I would like to highlight two important events that we are looking forward to this year. First, we plan to release our 2023 Sustainability Report in late April. Over the past year, we have continued to make remarkable strides to minimize our environmental impact, while delivering increasingly efficient and sustainable solutions for our customers that support critical ESG principles. This year's report will feature even more examples of how we are conserving resources and improving life for our stakeholders. Later this year, we plan to host a conference call to highlight our accomplishments and share more about our ESG journey at Valmont.

Second, I'm excited to announce that we will be holding an Investor Day on Tuesday, May 23, at the New York Stock Exchange. This will be an opportunity to connect with many of you face-to-face and present an updated look at our long-term strategy and financial targets. We will be providing details soon and I hope you are able to join us.

With that, I will now turn the call over to Avner for our fourth quarter financial review and updated outlook.

Avner M. Applbaum

Executive Vice President & Chief Financial Officer, Valmont Industries, Inc.

Thank you, Steve, and good morning, everyone. Turning to slide 9 and fourth quarter results, my comments will focus on the adjusted results, as outlined in the press release and in the Reg G disclosure in the presentation appendix.

Operating income grew 33% and sales growth of 17.5% with operating margins increasing to 10.1%, reflecting execution of our disciplined pricing strategy, higher volume and improved fixed cost leverage. Diluted earnings per share grew 31% to \$3.57, attributable to higher operating income, partially offset by a higher tax expense due to a change in the geographic mix of earnings compared to last year.

Turning to slide 10, Infrastructure segment operating income increased to \$99.6 million or 13% of sales. We are benefiting from the advancement of our growth strategy and deliberate focus on products and services that generate higher returns and deliver exceptional value to our customers.

Moving to slide 11, Agriculture segment operating income increased to \$44.5 million or 13.4% of sales. The benefit of higher average selling prices and additional volume leverage were partially offset by higher SG&A, including incremental R&D expense for technology investments. Finally, as reported in Other, operating income for the offshore wind energy structures business was \$1.4 million or 4.3% of sales.

Turning to cash flow on slide 12, full-year operating cash flows were \$326 million, a meaningful improvement compared to last year, driven by diligent working capital management and a more stable raw material cost environment.

Turning to slide 13 for a summary of full-year capital deployment. Capital spending for the year was \$93.3 million, and we returned \$86.3 million of capital to shareholders through dividends and share repurchases, ending the quarter with approximately \$185 million of cash. We continue to maintain a balanced approach to capital allocation of reinvesting in our businesses, which enables us to grow organically and inorganically, while returning cash to shareholders. Additionally, return on invested capital grew to 13.3%, a meaningful 160-basis-point improvement compared to last year, led by strategic capital allocation and improved working capital performance.

Moving to slide 14, strong cash generation this quarter allowed us to reduce total borrowings by approximately \$66 million, further strengthening our balance sheet. Total debt to adjusted EBITDA of 1.5 times remains within our desired range of 1.5 to 2.5 times.

I will now review our 2023 outlook as shown on slide 15. We expect sales growth of 4% to 7%, which is in line with the positive preliminary outlook that we communicated last quarter after reflecting the divestiture of the offshore wind energy structures business. We expect mid- to high-single-digit volume growth and price growth in the low-single digit, partially offset by the effect of fixed pricing mechanisms in certain product lines. Adjusted diluted earnings per share is expected to grow 11% to 15% compared to 2022 to a range of \$15.35 to \$15.90, in line with the expectations that we communicated last quarter.

SG&A expense is expected to increase in 2023, reflecting higher labor costs and higher investments in innovation and R&D to support strong sales growth and digital transformation initiatives. We expect operating margin expansion led by strong market demand, improved operating efficiencies, fewer supply chain disruptions, and our continued pricing strategy. Further, our outlook assumes continued elevated inflation with stabilizing raw material costs, including steel. As such, we also expect a more normalized year for free cash flow and continued progress towards our stated goal of 1 times net earnings.

We are making strategic and significant investments into our business with an expected increase in capital investment this year of \$105 million to \$125 million. Growth is a cornerstone to our long-term financial success, and we are continuing to build upon the strength of our operations as we invest in our employees, R&D and innovation to drive opportunities that support our growth strategy.

Our effective tax rate is expected to be between 28% and 29%, primarily driven by our geographic mix of earnings. Finally, for modeling other expense purposes, higher interest rate in 2023 will lead to higher interest expense and a much lower pension benefit compared to 2022.

To summarize, we are confident in achieving our sales and earnings per share targets this year based on a robust backlog of approximately \$1.7 billion, the execution of our operations and strong project pipeline. We are leveraging our scale and global footprint to improve margin and mitigate supply chain challenges. Continued strong cash generation is enabling us to support our capital allocation framework, putting us on the path to achieve our long-term financial targets and drive sustainable shareholder value.

With that, I will now turn the call back over to Steve.

Stephen G. Kaniewski

President, Chief Executive Officer & Director, Valmont Industries, Inc.

Thank you, Avner. The fundamental market drivers for our segments shown on slide 16 have remained strong over the last several quarters, and we expect them to remain consistent as we look to 2023 and beyond, driven by secular, long-term end-market fundamentals. Through a combination of great market dynamics and outstanding execution, we have built a foundation for strong performance in the future.

Our commercial teams are working closely with our partners to understand their needs. Our technology development teams are creating innovative solutions to solve customer challenges. And our operations teams are improving productivity to meet strong demand and expand margins. We remain focused on aligning our businesses with these fundamental drivers to provide the best chance for success.

Turning to slide 17. In summary, while we expect the broader economy to be challenged in 2023, our end-market demand is proving to be resilient. We are doing a great job of winning business, being flexible and delivering on our commitments to our customers. In parallel, we are strategically investing in our employees and technology to ensure we stay at the forefront of innovation and continue to drive operational excellence initiatives across the organization to improve productivity. This leads to growth in profitability and cash flow, supporting our capital allocation framework and enabling additional investments and profitable growth.

I will now turn the call back over to Renee.

Renee L. Campbell

Senior Vice President-Investor Relations & Treasurer, Valmont Industries, Inc.

Thank you, Steve. At this time, the operator will open up the call for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. At this time, we will be conducting a question-and-answer session. [Operator Instructions] To allow for as many questions as possible, we ask that you please limit yourselves to one question and one follow-up. One moment, please, while we poll for questions. Thank you. And our first question is from Chris Moore with CJS Securities. Please proceed with your question.

Christopher Moore

Analyst, CJS Securities, Inc.

Good morning, guys. Thanks for taking a couple of questions. Great quarter, great year. Maybe we'll just start with backlog. So backlog, \$1.7 billion, up a little bit year-over-year, down from around that record level \$2 billion in Q3. Maybe you could talk about the areas that have had the biggest decline. And is that more a function of lead times shortening or demand in certain areas not quite as strong?

Avner M. Applbaum

Executive Vice President & Chief Financial Officer, Valmont Industries, Inc.

Hi. Thanks for the question. This is Avner. I'll start off. Well, the largest impact is from the divestiture of the offshore wind business, which had approximately \$250 million of backlog at the end of Q3. So that's the largest area. On top of that, we did have a lot of shipments in the ag business shipping some of our related project work. So that also drove some of the reduction in Q4.

Christopher Moore*Analyst, CJS Securities, Inc.*

Q

Got it. Very helpful. And maybe just one on the 12% operating target. So, obviously, Valmont operates in a lot of cyclical markets. You talked today why some of that is kind of improving a bit. But I'm looking at the 12% target as you might be able to reach that while most of the end markets are strong, but not necessarily a long-term sustainable number. Am I looking at that fairly or are you thinking of 12% and it stays at that level moving forward?

Avner M. Applbaum*Executive Vice President & Chief Financial Officer, Valmont Industries, Inc.*

A

I'll start off. We definitely see that as long-term sustainable target. We're planning to make significant progress in 2023, driven by a lot of the leveraging volume, some of the pricing, a lot of productivity improvement we're going to see in 2023 as we have less supply chain disruptions, more cost aligned with our pricing. So we will see significant progress in 2023. As we move into 2024, a clear line of sight as we communicated in the prior Investor Day. And that will be sustainable – should be sustainable over the long term.

Stephen G. Kaniewski*President, Chief Executive Officer & Director, Valmont Industries, Inc.*

A

And, Chris, I would add that my comments about the Infrastructure segment specifically, we don't see any kind of down cyclicity at a minimum over the next three to five years. I mean, there's enough out there that one could argue for 10 years between utility, telecom, traffic and lighting, etcetera. So the ag markets are still strong. And our technology initiatives and our ag solar initiatives really would mute, I'll say, if you go back in time, our typical cyclicity there. So we see a good line of sight to 12%.

Christopher Moore*Analyst, CJS Securities, Inc.*

Q

Perfect. I'll leave it there. Thanks, guys.

Operator: Thank you. And our next question is from Brian Drab with William Blair. Please proceed with your question.

Brian Drab*Analyst, William Blair & Co. LLC*

Q

Hi. Good morning. Thanks for taking my questions. I thought I would start just first on pricing. You've mentioned pricing kind of qualitatively throughout the call today, but I was wondering if you could talk about what you expect to see in terms of pricing within your utility business this year, the highway infrastructure business, and just kind of take us through the business lines and tell us what you're expecting?

Stephen G. Kaniewski*President, Chief Executive Officer & Director, Valmont Industries, Inc.*

A

Yeah. Brian, if you look, first and foremost, at utility and the lead times ramping up to over 40 weeks, most of the demand was understated from most of the reports that were out there. And in our appendix, we actually put in a graph showing kind of how the real market played out. So with everything going on with electrification, load growth, grid hardening, there's really no reason that should back off and price should remain very strong. In the telecom market, it is our highest priced area. And although there is a little bit of inventory pullback early here in

the year, we're not even into the densification efforts around 5G. And so there's no reason there that you should see price move.

The DOT work, although we're just starting to see some of the highway infrastructure bill kind of quotes and orders come through, the states were going full bore. So lead times and orders and quotes in lighting and traffic remain very strong. So again, no reason to move. The coatings business has continued to move up price and will continue to move up price. And on the Agriculture side, there's no reason to move backwards anywhere there either. So we feel very strong that the price that was gained over the last couple of years will hold just based on the market dynamics of supply and demand.

Brian Drab

Analyst, William Blair & Co. LLC

Got it. Thanks. And then shifting to solar, can you talk a little bit more about where did you end the year in terms of revenue for the solar tracker business? And then in terms of revenue, where did you end the year in the ag solar business and what do you expect for those two businesses in 2023? Thanks.

Avner M. Applbaum

Executive Vice President & Chief Financial Officer, Valmont Industries, Inc.

Yeah. Hi. So this is Avner. So first of all, in the solar in the Infrastructure part of the business, we more than doubled our revenue to over \$120 million. So really strong results there and continue – we're expecting to continue high growth this year as well based on all the market demand. On the ag side of the business, we had – also in that area we had a strong performance, strong growth in that area as well. And based on the expected CAGRs there between 15% to 20%, we should continue to see the strong growth in that area as well.

Brian Drab

Analyst, William Blair & Co. LLC

Okay. I'll follow up more later. Thank you.

Operator: Thank you. And our next question is from Jon Braatz with Kansas City Capital. Please proceed with your question.

Jonathan P. Braatz

Analyst, Kansas City Capital Associates

Morning, everyone. Steve, you mentioned – you talked early on in your commentary about some additional investments in the utility area because lead times are getting extended to 40 weeks. And I guess, my question is maybe twofold. Number one, how big of expansion, physical – I guess, physical expansion? And then secondly, what do you see other your competitors doing in terms of physical expansion in that regard, too?

Stephen G. Kaniewski

President, Chief Executive Officer & Director, Valmont Industries, Inc.

Yeah. So, Jon, we take a very measured approach to capacity additions, and we look at labor productivity first and foremost. We look at our existing footprint and from a lean perspective what more can we get out of them through 3P and other types of exercises. And then once we do that, we then can assess where to actually add capital. So what we're doing and what's reflected in our capital plan for 2023 is kind of to the extent of expanding our capacity. So it's not an over – here's a brand-new facility. It's taking many of our existing facilities and further

adding to them or leaning them out both ways. So we're looking at that. We'd like to have a target between 26 and maybe 34 weeks, ultimately, within the utility area.

I think competitors have been rational as well. Everyone has really kind of added capacity in a very measured approach to meet kind of the market growth. And so I think you'll see that the long-term drivers in utility are really being buttressed by kind of three factors, right? First and foremost, there's load growth after two decades of no load growth. You have the energy transition that's taking place and then you have the grid hardening. And so those three factors really give a good line of sight to adding capacity and not necessarily doing it ultra-quick, but just to make sure that you can maintain that proper balance between supply and demand and, obviously, pricing that goes with it.

Jonathan P. Braatz

Analyst, Kansas City Capital Associates

Okay. Thank you very much.

Operator: [Operator Instructions] Our next question comes from Nathan Jones with Stifel. Please proceed with your question.

Adam M. Farley

Analyst, Stifel, Nicolaus & Co., Inc.

Good morning. This is Adam Farley on for Nathan. I wanted to start with the Ag segment. So the USDA forecast is down this year, but it sounds like underlying fundamentals are strong. Could you help us balance how you're thinking about farmer sentiment and maybe a potential delay to the start of the season?

Stephen G. Kaniewski

President, Chief Executive Officer & Director, Valmont Industries, Inc.

Yeah, Adam. There's two factors when you look at the USDA projections, kind of like the under the covers piece of it. One, they really didn't account for the decline in inputs. So, as fertilizer prices dropped, transportation prices dropped, nitrogen prices dropped, it's not really reflected in there. We've been talking to a number of economists that this is what they do all the time, and they've pointed that out to us and it's a good reference point.

The other is where the biggest drop in net farm income is going to take place, and it's not really with our growers. It's more in the livestock and kind of finished areas, where there's more decline in net farm income. And so what we're seeing and others in the industry have already kind of pointed out over the past couple of weeks is that there's still very strong underlying growth. They still hate to pay taxes. They will make money. And there's a good return, particularly with the drought conditions that have occurred across the globe for our types of products. So we feel that that really provides a stability in the market as we look through 2023.

Adam M. Farley

Analyst, Stifel, Nicolaus & Co., Inc.

That makes a lot of sense. And then more broadly, can you provide more color on your supply chain. Are you expecting improvement in the supply chain? Are you – what are you seeing today? Is it leveling out? Is it getting better?

Stephen G. Kaniewski

President, Chief Executive Officer & Director, Valmont Industries, Inc.

Yeah. The supply chain has definitely improved over the last couple of quarters. I would say second quarter of last year was most acute, most of the issues, because we had the pandemic restrictions kind of early in Q1. There's still a little bit of whack-a-mole going on, but it's not whack a whole bunch of moles. So it's things that I think our team is very capable of handling. And we've really been able to kind of tune the supply chain for the new normal and really make some appropriate calls, whether it's inventory or forecasting, etcetera, as a part of that.

Adam M. Farley

Analyst, Stifel, Nicolaus & Co., Inc.



Okay. Thank you for taking my questions.

Operator: We have reached the end of the question-and-answer session. And I will now turn the call over to Renee Campbell for closing remarks.

Renee L. Campbell

Senior Vice President-Investor Relations & Treasurer, Valmont Industries, Inc.

Thank you, everyone, for joining us today. As mentioned, today's call will be available for playback on our website or by phone for the next seven days. And we look forward to speaking with you again next quarter.

Operator: Included in this discussion are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements are based on assumptions that management has made in light of experience in the industries in which Valmont operates, as well as management's perceptions of historical trends, current conditions, expected future developments, and other factors believed to be appropriate under the circumstances.

As you listen to and consider these comments, you should understand that these statements are not guarantees of performance or results. They involve risks, uncertainties, some of which are beyond Valmont's control and assumptions. Although management believes that these forward-looking statements are based on reasonable assumptions, you should be aware that many factors could affect Valmont's actual financial results and cause them to differ materially from those anticipated in the forward-looking statements.

These factors include, among other things, risk factors described from time to time in Valmont's reports to the Securities and Exchange Commission, as well as future economic and market circumstances, industry conditions, company performance and financial results, operating efficiencies, availability and price of raw material, availability and market acceptance of new products, product pricing, domestic and international competitive environments, and actions and policy changes of domestic and foreign governments.

The company cautions that any forward-looking statement included in this discussion is made as of the date of this discussion, and the company does not undertake to update any forward-looking statements.

This concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation.

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