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The Estée Lauder Companies, Inc. (EL)

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CORPORATE PARTICIPANTS

Tracey Thomas Travis

Chief Financial Officer & Executive Vice President, The Estée Lauder Companies, Inc.

OTHER PARTICIPANTS

Lauren R. Lieberman

Analyst, Barclays Capital, Inc.

MANAGEMENT DISCUSSION SECTION

Lauren R. Lieberman

Analyst, Barclays Capital, Inc.

We're pleased to welcome back Tracey Travis, Estée Lauder's Executive Vice President and Chief Financial Officer, who's going to participate in a Q&A session with me.

So, Tracey, it's great to see you this morning. It's been far too long.

Tracey Thomas Travis

Chief Financial Officer & Executive Vice President, The Estée Lauder Companies, Inc.

It certainly has.

QUESTION AND ANSWER SECTION

Lauren R. Lieberman

Analyst, Barclays Capital, Inc.

Q

Yeah. I'm not okay with any of this, but this is better than nothing. So, I know it's been just a few weeks since earnings, but these days it feels like anything can change on a dime, I mean, the latest news on EU travel restrictions being case in point. So, if you could just first maybe take a quick walk around the world and comment on your own business and how it's fared recently with this kind of rolling state of affairs.

Tracey Thomas Travis

Chief Financial Officer & Executive Vice President, The Estée Lauder Companies, Inc.

A

Yeah. Well, this rolling state of affairs obviously has been going on for about 18 months or so, and still going, to your point. So, not much since we announced earnings. At that time, we had started to see – had seen lockdowns in the Asia Pacific region. Some of that has eased. But by and large, we still have more doors closed in the Asia Pacific region than we had last year at this time.

The flip side of that is in North America, we are continuing to see momentum in North America. So, very consistent with what we were seeing a few weeks ago. Europe seems to be stabilizing a bit and slowly recovering. So, almost the exact opposite of what we saw a year ago this time. So, it's – we have gotten used to, as many companies have, navigating in this environment. And – but we're very pleased to see the momentum that we're now seeing in North America, UK picking up a bit, and certain countries in Europe as well. So, our western market is picking up a bit.

Lauren R. Lieberman

Analyst, Barclays Capital, Inc.

Q

Okay. That's great. And when I think specifically about the first quarter guidance, the 11% to 13% growth, does imply a pretty big deceleration if you look at it on like a three-year average growth rate, which I don't know if that's a right way to look at things or not, but it's what we're kind of attempting to figure this out.

Tracey Thomas Travis

Chief Financial Officer & Executive Vice President, The Estée Lauder Companies, Inc.

A

Yeah.

Lauren R. Lieberman

Analyst, Barclays Capital, Inc.

Q

So, are you building in – is this conservatism around Delta variant? Or is there something that I'm missing in the comparisons that we should be thinking about that's informing that deceleration?

Tracey Thomas Travis

Chief Financial Officer & Executive Vice President, The Estée Lauder Companies, Inc.

A

Yeah. No, it's primarily the Delta variant when you think about the regions that are impacted right now as it relates to some of the shutdowns. And in our eastern markets, we're optimistic throughout the year, as vaccination rates increased, that we'll see less of those shutdowns. But right now, the control mechanism in those regions is to actually shut down doors, and that seems to be working to quickly contain in certain markets like China and other

markets the spread of the variant when we see an uptick. So, we expect to navigate this choppiness throughout certainly the first half of our fiscal year, and hopefully seeing progressively less of that in the second half of the year, unless there's a new variant that comes out, which I can't...

Lauren R. Lieberman

Analyst, Barclays Capital, Inc.

Yeah.

Q

Tracey Thomas Travis

Chief Financial Officer & Executive Vice President, The Estée Lauder Companies, Inc.

...predict, so.

A

Lauren R. Lieberman

Analyst, Barclays Capital, Inc.

Okay. All right. Great. Let's move on more strategic. And so I felt like on the earnings call there was maybe a little bit more of an emphasis on diversity of sales growth by category and channel than in the past where it's been skin care online, Chinese consumers worldwide. So, what's the genesis of this discussion if I'm sort of sensing something that there? Is it about makeup? Is it about specific innovations within categories? But I did feel like there was that [indiscernible] (03:51) something new to the conversation.

Q

Tracey Thomas Travis

Chief Financial Officer & Executive Vice President, The Estée Lauder Companies, Inc.

Yeah. Well, the conversation has always been about diversified engines of growth, as you know, Lauren. Certainly throughout the pandemic we've had more concentrated growth. We've had terrific growth out of our China and Asia region, but in particular China, and terrific growth in certain pockets of travel retail, China as well as in Korea, and the rest of the regions have been quite challenged. And then skin care obviously being a growth driver even pre-pandemic.

A

As we think about emerging from the pandemic, and I mentioned that North America was growing quite nicely now, North America has been a large makeup market. And so we expect this year, growth drivers to come from makeup. In addition, skin care and online will still be big drivers. But makeup will recover and also fragrance. I mean, fragrance was the big surprise for many of us in the industry throughout the pandemic. And we see a lot of momentum and growth heading into the holiday season with our fragrance category as well. So, we will see more growth from other categories in addition to skin care and certainly other regions in addition to in our Asia Pacific.

Lauren R. Lieberman

Analyst, Barclays Capital, Inc.

Okay. And on that note, I had actually been also particularly interested in the call out of hair care as an emerging growth engine. It's 4% of sales. I know it's a smaller part of the business, but why now, right, in terms of starting to call that out and mentioned it?

Q

Tracey Thomas Travis

Chief Financial Officer & Executive Vice President, The Estée Lauder Companies, Inc.

Yeah. We have seen some fantastic progress in particularly our Aveda brands. We have two hair care brands, Aveda and Bumble. We've been doing, with new leadership in both of those brands, a lot of work to reposition those brands for growth. Aveda is now a vegan brand. They came out with some fantastic innovation that really

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resonated last year, they – actually the last couple of years. They have really focused in terms of positioning the brand online and working with our salon retailers as well to help them sell more product online, which was certainly well-appreciated during the pandemic when a lot of the salons were actually closed.

So, as we look at the innovation pipeline for both, in particular for Aveda, but for Bumble as well, and we're encouraged that they will continue to see the kind of growth and momentum that we saw last year, which was nice to see. It's been a while since we've had really good growth in our hair care category.

Lauren R. Lieberman

Analyst, Barclays Capital, Inc.

Q

Okay. Great. Let's focus on North America, which you started to, but I'm going to go a little deeper. So, you've mentioned on the call that fiscal 2022, you'd see top line growth and margin expansion, in addition to makeup. Could you just drive us through kind of the key drivers of that? How much of it is dependent on expanding consumer reach? Because I know I think there'll be some presence in the [indiscernible] (07:01) outposts of Sephora and Ulta. So, just curious how that plays into that growth forecast as well.

Tracey Thomas Travis

Chief Financial Officer & Executive Vice President, The Estée Lauder Companies, Inc.

A

Yeah. I mean, I think much of it is a resumption of brick-and-mortar business. So, we did a terrific job in the last year driving online. Online will still be a contributor to growth in North America. But as people start to go back to work, back to school, back to social events, the makeup category picks up and brick-and-mortar sales pick up. So, we would – we expect growth across all of our channels of distribution in North America.

We certainly have done a lot in terms of customer acquisition during the pandemic, and so we certainly expect that that will continue to be a growth driver. When you think about the new distribution which we're very excited about in terms of Ulta's partnership with Target and Kohl's, and Sephora on that partnership. Still a small number of doors. There's the online portion of that, and that will build over time. But that will be a contributor, but not a huge driver. It really is the pickup of the rest of the business. And DECIEM and Dr. Jart+, and so Dr. Jart+ being a little smaller, a lot of the distribution and growth of Dr. Jart+ is in eastern markets, but it does have presence here in North America. But DECIEM has quite a bit of presence in North America, both in Canada as well as in the US. And that obviously will be realizing a full – almost a full year of growth of DECIEM. We had five weeks of growth in our numbers last year as we acquired a majority of the brand. So that, too, is a driver of growth in North America.

So, we've got a number of new things, the momentum in fragrance, the momentum in hair care, small, but the new distribution to your point and DECIEM, and fragrance as well, that we're quite excited about for this year in terms of growth in North America.

Lauren R. Lieberman

Analyst, Barclays Capital, Inc.

Q

Okay. And what do you think a longer-term growth rate should look like for North America? And also when you think about it versus prestige category growth, I mean, can Estée, do you think, gain share or get back to a position of gaining share in North America or is growing in line with the category sort of a strong enough aspiration?

Tracey Thomas Travis

Chief Financial Officer & Executive Vice President, The Estée Lauder Companies, Inc.

A

Well, right now, growing in line with the category is what we are primarily focused on, but, of course, we would look to try to gain share. We continue to be the share leaders in North America. But obviously we have ceded share to indi brands largely in North America as you know well, Lauren. So, we certainly hope, with some of the strategies that we have undertaken over the last few years, really diversifying our channels of distribution, so much more presentation in specialty multi, a tighter distribution in other channels whether that be in department stores or even in freestanding stores with some of the programs that we've executed over the last couple of years, that that will balance out the growth in North America and an increase in advertising. So, we have certainly increased our advertising as we've shifted our distribution, which is important from a market growth standpoint. So, all of those things we believe will get us back to category prestige growth and then hopefully beyond.

Lauren R. Lieberman*Analyst, Barclays Capital, Inc.*

Q

Okay. And what about margins? I mean, 13.5% or 13.6% last year in North America is well below corporate average. So, how do you think about profitability in North America over the longer-term?

Tracey Thomas Travis*Chief Financial Officer & Executive Vice President, The Estée Lauder Companies, Inc.*

A

Yeah. If you look back on our North America margin over the last decade, you'll see that North America or the Americas segment, I should say, has always been lower than the other regions. So, that's primarily because corporate expenses are embedded in that Americas region. So, it's really on a legal entity bases. If you look at the region and strip out the corporate expense and even some of the travel retail expense that it gets – or profit that gets allocated back, the Americas region certainly declined when makeup declined, makeup being heavy brick-and-mortar category for us with M·A·C freestanding stores and some of the other department store distribution that we've been navigating through.

Some of the actions that we've taken, or a lot of the actions that we've taken, have been very much targeted on improving the operating margin in the Americas, both in Canada as well as in the US, and we've actually taken actions in Latin America as well to close some distribution.

So, we – the – as we look at this year and the next couple of years, the expectation for the Americas, excluding the corporate expenses, are really comparable to other regions, and so comparable to our EMEA region, excluding travel retail. And our APAC region is a little bit higher because of the productivity per door that we see in many of the Asia markets. But it's really much closer to the corporate average than it looks in terms of the disclosure because of the corporate expenses that are embedded in there.

Lauren R. Lieberman*Analyst, Barclays Capital, Inc.*

Q

Okay. Great.

Tracey Thomas Travis*Chief Financial Officer & Executive Vice President, The Estée Lauder Companies, Inc.*

A

The other improvement, and a lot of the acquisitions that we've done over the last few years, particularly in the makeup category, have been very much focused on US brands. And to the extent the makeup category obviously has, in general, underperformed with those brands, they had also been a bit of a drag on primarily more so the Americas region than the other regions.

Lauren R. Lieberman

Analyst, Barclays Capital, Inc.

Q

Okay. Let's switch to China. So, first, housekeeping. I think last year at the conference, we talked about China being that 18% of sales, and including travel retail, it was 24%. How big was China for fiscal 2021? Just housekeeping to begin with.

Tracey Thomas Travis

Chief Financial Officer & Executive Vice President, The Estée Lauder Companies, Inc.

A

Yeah. So, China was about 34% if you include travel retail. Now, again, remember, what happened last year, obviously China grew, and – but the rest of the regions were somewhat depressed. So, some of that is just based on where we saw growth and where we didn't from a mixed standpoint.

The other thing to recognize is as countries were – people weren't traveling. International travel wasn't happening. A lot of the international travel that would have shown up in other regions certainly showed up in China. So, that – those two factors really drove the kind of mix that we saw last year. It's hard to read, Lauren, a lot out of last year other than we will continue to progress the overall business. But some of the mixed things that in terms of where we landed the year, as we get further into recovery, you'll see more balanced growth and you'll see more balanced mix than you saw in fiscal 2021 or fiscal 2020 for that matter.

Lauren R. Lieberman

Analyst, Barclays Capital, Inc.

Q

Okay. I think online is about 50% of sales in China. So, I was curious I guess, A, how much more can it become over time, or if that feels like the right balance? And also, how many of your brands are in China are already on Tmall? And how many have launched on JD, because I thought this JD versus Tmall dynamic is an emergent one when we think about prestige beauty?

Tracey Thomas Travis

Chief Financial Officer & Executive Vice President, The Estée Lauder Companies, Inc.

A

Yeah. So, online was a little less than 50%. I think it was about 47% in China, kind of get to 50% probably. Can it get beyond? China is one of the most well-developed markets as it relates to online sales, with the strength of some of the platforms there. So, possibly. I mean, especially as we expand to your point into other platforms, and other platforms are growing quite a bit in China right now.

We have 11 brands on Tmall. Obviously, our largest brands and then some of our mid-sized in here, and even some of our smaller skincare brands, as well as Bobbi and a couple of our fragrance brands as well like Jo Malone. So, we have 11 brands on Tmall.

We started with four brands on JD, and we just started, as you know, at the beginning of this fiscal year. And so we are monitoring that. The platforms are a little bit different. We know that we are broadening our reach in terms of some of the distribution that we have on JD as we look at the consumer base and it is skewing a bit more [ph] mail (16:50), which is good. And so we are – we have had the ability to recruit some new consumers as a result of the JD expansion. So, we'll monitor that and determine how many brands we will ultimately have on the JD platform really matching it up with the consumer traffic that we see on the platform.

Lauren R. Lieberman

Analyst, Barclays Capital, Inc.

Q

Okay. Great. And last question on China is just your High-Touch model online, livestreams, virtual try-ons and so on, I was just curious how you would describe it as differentiated versus other beauty players because I feel like these things have very quickly become what everyone is doing and has to do. So, how would you say Lauder's offerings in this front are different than competitors?

Tracey Thomas Travis

Chief Financial Officer & Executive Vice President, The Estée Lauder Companies, Inc.

A

Well, the biggest difference we have is our brand portfolio, so.

Lauren R. Lieberman

Analyst, Barclays Capital, Inc.

Q

Yeah.

Tracey Thomas Travis

Chief Financial Officer & Executive Vice President, The Estée Lauder Companies, Inc.

A

And we are a top brand in a portfolio company in China in terms of the portfolio brands that we have. And so we have very high repeat in China with our brands. So, it's the strength of our brands, first and foremost. Certainly, we are leveraging a lot of the techniques that China has been very innovative in terms of some of the techniques that they've used. And certainly, at the start of the pandemic, seeing that escalate which we adopted in some other markets as well.

I would say that some of our – the creativity of our branding as well is differentiated also in China. I think our team does a very good job of presenting the luxury element of our brands. We also have utilized during the pandemic some of our beauty advisors, which we've done in other markets also to sell online. And that's done quite well in China also when some of the brick-and-mortar distribution was closed or restricted. So – but, yes, I mean, there are a number of companies utilizing the same techniques, but not necessarily with the same brand desirability or with the same creativity that our teams have been executing.

Lauren R. Lieberman

Analyst, Barclays Capital, Inc.

Q

Okay. I want to broaden out the question on virtual try-ons and really technology [indiscernible] (19:18) global question. I mean, you've talked about technology investments for several years, right, data analytics, consumer experience in stores and online. But I'm curious, I guess, first, how those investments have changed since the start of COVID, and if you shifted that allocation of spend on technology. And then also sticking with the virtual try-on question, I mean, it seems to me like a huge opportunity for increasing basket size and trial. I mean, you can try on an infinite number of lipsticks without making your face all red and messy, right, versus in person. So, how big do you think that could be? Do you, in fact, see higher basket size when virtual try-on is being used?

Tracey Thomas Travis

Chief Financial Officer & Executive Vice President, The Estée Lauder Companies, Inc.

A

Yeah, we definitely do. So, starting with your first question on technology, we had a lot of beauty technology investments that we were trying and testing prior to the pandemic hitting. So, the great thing about that is we were able to escalate some of those things, whether it was virtual try-on or leveraging some of our beauty advisors, shifting them to online to sell, livestreaming which again started in China and was adopted in some of the other markets, really amping up our videos that otherwise you would get that experience in a store, you could get online in terms of teaching you how to do various skin care treatments or makeup treatments. So, we scale those pretty quickly.

We have virtual try-on now on our largest sites. So, a decent amount of our online sales is enabled by virtual try-on. And we do see a higher conversion rate from virtual try-on. So, that's something that we will continue to do. We also see, Lauren, a higher engagement and conversion and basket size from virtual selling. So, actually having a beauty advisor online that actually can consult with a consumer who wants that experience, whether you want to explore lipsticks, you can do virtual try-on with lipsticks, to your point. And then if you're not quite sure, you can actually access a beauty advisor to help you and consult with you to close the deal or to create a full look, if you want it. So, those things have really helped to increase the amount of time spent online, the amount of engagement that we see repeat, and certainly conversion. And it's been a driver certainly for our brand dot-com sites as well as our platforms. And we've worked with some of our retailers as well to adopt some of those same technologies to improve our business on their sites as well.

Lauren R. Lieberman

Analyst, Barclays Capital, Inc.

Q

Okay. Great. Let's see. I'm deciding where I want to, in the interest of time, where I want to go next. Let's just switch gears and talk about margins and profitability. So, it's been roughly a year since you announced the post-COVID restructuring plan. Can you just provide an update on major initiatives that were underway in fiscal 2021? And have you been able to accelerate the reduction in freestanding doors and unproductive department stores, anything greater than was originally anticipated?

Tracey Thomas Travis

Chief Financial Officer & Executive Vice President, The Estée Lauder Companies, Inc.

A

Yeah. I would say, by and large, we're on track with – and we're not done. So, in terms of the rationalization of the brick-and-mortar footprint, we started with Latin America and the UK. And really, in the case of some of our department stores, some of our brands that were underperforming pulled out of some of the department store doors. In the case of our own freestanding stores, closed the unprofitable freestanding stores, those that we did not believe would recover post-COVID. So, in terms of the 10% to 15% number that we anticipated for freestanding stores, we're pretty close to that number right now. And again, we're not done with the program, so we may end up at the end of the program with more than what we had originally anticipated.

We also took the opportunity to look at our brand portfolio, and we did take action on a couple of our brands, BECCA and Rodin being two that also, as we looked at post-COVID, the recovery, not being what we would have expected, and so took actions on those brands.

And then in the last area that primarily we took actions on, and we had a number of different programs and we'll have some this year as well, is looking at the structure that we have to support brick-and-mortar sales and recognizing that we've got now a diversified footprint. We've got more specialty multi-business. We've got less department store business, particularly in our Western markets, making sure that the support structure that we had for brick-and-mortar and for online was appropriate. And so we did do some shifting of resources there to rationalize and make sure we're providing the right coverage across channels and also in a cost-efficient manner.

So, that – those are the actions that we've taken. I mean, those actions will largely benefit our Americas region from a margin standpoint, as well as our EMEA region, most of those actions really being taken in the Western markets.

Lauren R. Lieberman

Analyst, Barclays Capital, Inc.

Q

Okay. And of the \$300 million to \$400 million in savings in 2021, how much are you anticipating in 2022? I don't know if that's a figure we have a ballpark on yet.

Tracey Thomas Travis

Chief Financial Officer & Executive Vice President, The Estée Lauder Companies, Inc.

A

Yeah. Again, that \$300 million to \$400 million is a gross number. And obviously part of what we've done is reinvest some of those savings back into online. But we have – we are expecting to get about \$100 million of that savings in fiscal 2022.

Lauren R. Lieberman

Analyst, Barclays Capital, Inc.

Q

Okay.

Tracey Thomas Travis

Chief Financial Officer & Executive Vice President, The Estée Lauder Companies, Inc.

A

A little of it happened in the second half of fiscal 2021 [ph] by (26:05) about \$100 million, and ramping up to \$100 million in fiscal 2022.

Lauren R. Lieberman

Analyst, Barclays Capital, Inc.

Q

Okay. Great. So, taking that plus the conversation around channel shift, right, and channel shifting accretive to profitability, and I mean we've been writing about it for four years, and then COVID happens and the whole thing really accelerates. You mentioned on the earnings call that online and travel retail combined are now 57% of sales [indiscernible] (26:32) in fiscal 2021. And that's up from about 40%, I believe, in fiscal 2019. So, with these two channels being the most profitable, and our estimate is it's like, call it, 500 basis points above the corporate average. Look, what does that mean in terms of that long-term margin expansion goal, the 50 basis points per year, right? Again, if we had this giant channel shift, how do we put that in the context of the 50 basis points per year that's in the algorithm?

Tracey Thomas Travis

Chief Financial Officer & Executive Vice President, The Estée Lauder Companies, Inc.

A

Yeah. I would, again, remember what I said before, that fiscal – it's really difficult to look at fiscal 2021 as a norm. And so when you think about where we expect incremental growth this year, it's brick-and-mortar and it's makeup. And so those do have lower margins and overall greater profitability with more balance with the diversification. But I would say when COVID normalizes, we expect that we will end up with a higher percent mix of online. We will have a higher percent mix of travel retail as well when international travel resumes. And we've talked a lot about Hainan and the expectation, that just given the different nature of travel for Hainan, that that will continue to be a growth driver for us.

But we will see specialty multi grow. We will see department stores grow as well. And so you'll see a bit more balance. And so that a normalized growth mix for us is that 50 basis points of margin expansion that we speak about in 6% to 8% top line growth. This will not be a normal year either, obviously, as you can tell from the guidance that we've given. So, we're still emerging from the pandemic. But that algorithm, that financial algorithm which we've had for some time, allows us to invest back into the business to continue growth, invest in our brands, invest in infrastructure which we're doing quite a bit right now as well to support the growth that we expect to have over the next few years.

Lauren R. Lieberman

Analyst, Barclays Capital, Inc.

Q

Okay. So, part of this then it's not that there's something where people are missing that in understanding the relative profitability of the channels. It's that part of it is there's an expectation that channel mix is not static with what it looked like in 2021.

Tracey Thomas Travis

Chief Financial Officer & Executive Vice President, The Estée Lauder Companies, Inc.

A

Yes.

Lauren R. Lieberman

Analyst, Barclays Capital, Inc.

Q

And so you've built in – and also category mix. And even if makeup – as makeup comes back, it should be a lot more profitable than it was...

Tracey Thomas Travis

Chief Financial Officer & Executive Vice President, The Estée Lauder Companies, Inc.

A

That's right.

Lauren R. Lieberman

Analyst, Barclays Capital, Inc.

Q

...pre-COVID because [indiscernible] (29:21) the program, but it's still not skin care.

Tracey Thomas Travis

Chief Financial Officer & Executive Vice President, The Estée Lauder Companies, Inc.

A

That's right.

Lauren R. Lieberman

Analyst, Barclays Capital, Inc.

Q

Is that okay?

Tracey Thomas Travis

Chief Financial Officer & Executive Vice President, The Estée Lauder Companies, Inc.

A

That's right.

Lauren R. Lieberman

Analyst, Barclays Capital, Inc.

Okay. Okay. [indiscernible] (29:27) great. I'm out of time. I want to keep going, but I can't. So – but really it was great to see you. I really look forward to seeing you in person and having more time for more questions and more conversation. So...

Tracey Thomas Travis

Chief Financial Officer & Executive Vice President, The Estée Lauder Companies, Inc.

Absolutely, Lauren. Thank you.

Lauren R. Lieberman

Analyst, Barclays Capital, Inc.

...thanks for the time. Okay.

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