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The Estée Lauder Companies, Inc. (EL)

Q4 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day everyone, and welcome to The Estée Lauder Companies Fiscal 2023 Fourth Quarter and Full Year Conference Call. Today's call is being recorded and webcast.

For opening remarks and introductions, I would like to turn the call over to the Senior Vice President of Investor Relations, Ms. Rainey Mancini.

Laraine A. Mancini

Senior Vice President-Investor Relations, The Estée Lauder Companies, Inc.

Hello. On today's call are Fabrizio Freda, President and Chief Executive Officer; and Tracey Travis, Executive Vice President and Chief Financial Officer.

Since many of our remarks today contain forward-looking statements, let me refer you to our press release and our reports filed with the SEC where you'll find factors that could cause actual results to differ materially from these forward-looking statements. To facilitate the discussion of our underlying business, the commentary on our financial results and expectations is before restructuring and other charges and adjustments disclosed in our press release.

Unless otherwise stated, all organic net sales growth also excludes the non-comparable impacts of acquisitions, divestitures, brand closures, and the impact of foreign currency translation. You can find reconciliations between GAAP and non-GAAP measures in our press release and on the Investors section of our website.

As a reminder, references to online sales include sales we make directly to our consumers through brand.com sites and through third-party platforms. It also includes estimated sales of products through our retailers' websites. During the Q&A session, we ask that you please limit yourself to one question so we can respond to all of you within the time scheduled for this call.

And now, I'll turn the call over to Fabrizio.

Fabrizio Freda

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

Thank you, Rainey, and hello to everyone. We appreciate you joining us to discuss our fiscal year 2023 results and outlook. Let me begin with the fourth quarter. We delivered an organic sales increase of 4%, achieving a return to growth for the quarter as expected. Momentum continued in the markets of EMEA and Latin America and accelerated in Asia/Pacific, where organic sales growth improved from 7% in the third quarter to 36% in the fourth quarter, led by mainland China and Hong Kong SAR.

Looking at the full year, while demand for our business is still strong with retail sales growth up mid-single digit globally, organic sales declined 6%. We delivered impressive double-digit growth in the markets of EMEA and returned to growth in Asia/Pacific, while the Americas held steady. These gains across the markets of EMEA and Asia/Pacific were more than offset by Asia travel retail, given the prolonged and complex recovery from the pandemic, as we have discussed in our previous earning calls.

Indeed, our global travel retail business decreased 34% organically in fiscal year 2023, solely driven by Asia travel retail. Our travel retail business in EMEA and the Americas soared, and our investment in activation and in-store beauty advisor drove strong performance, as passenger traffic increased.

The rest of our business in total rose 5% organically, as growth accelerated from 10% in the third quarter to 17% in the fourth quarter. The challenges in Asia travel retail disproportionately pressured Skin Care, which is our highest-margins category. Compounding matters, the leverage was pronounced as the lower level of sales coincided with the elevated strategic investment in manufacturing and R&D capabilities, as well as information technology for our online business and to support our expanding supply chain globally. All told, our adjusted operating margin contracted meaningfully in fiscal year 2023 to 11.4%, modestly better than we expected in the revised outlook we offered in May.

During fiscal year 2023, we continued to make progress on our sustainability goals and commitments. For our packaging goals, for instance, we have now advanced from 51% of our packaging being recyclable, refillable, reusable, recycled or recoverable in fiscal year 2019 to over 70% in fiscal year 2023. As well, we are on track to maintain our status of 100% renewable electricity and Scope 1 and Scope 2 carbon neutrality.

We are proud to have been recognized by CDP for our continued commitment to disclose our environmental impact, as reflected in our CDP Climate, Water and Forest disclosure scores for 2022. Most notably, we achieved an A- for our climate change disclosures and we earned a place in the prestigious A List for Water, improving our score over 2021.

Looking ahead, for Asia travel retail, the pressure in Hainan intensified over the course of the fourth quarter. In May and June, retail sales trends deteriorated and turned steeply negative following the enforcement actions to control daigou activity. The implication of these are favorable for sustainable, long-term growth, but certainly create significant short-term headwinds through the transition.

As we embark on fiscal year 2024, we have four strategic imperatives; drive momentum where our business is driving, reaccelerate growth in the United States, capture demand for the returning individual traveler in Asia travel retail, and begin to rebuild our profitability. For fiscal year 2024, we expect to return to full-year organic sales growth and margin expansion, with organic sales rising 6% to 8% and adjusted operating margin improving sequentially throughout the year. Our fiscal year 2024 action plan where we expect to again increase our investment in advertising as a percentage of sales will also set the stage for a stronger fiscal year 2025 acceleration.

One of our greatest strengths to leverage in our return to top and bottom line growth is our diverse portfolio of nearly 25 brands. Sitting at the top are our \$4 billion-plus brands of Clinique, Estée Lauder, La Mer, and M·A·C, each a winner in its own right. M·A·C, the world's biggest prestige makeup brand, was our best-performing brand across the entire portfolio in fiscal year 2023. Its unrivaled artistry hero products, strong earned media value ranking, and breakthrough innovation of the Hyper Real franchise in Skin Care drove excellent results.

For fiscal year 2024, the brand is on the cusp of a big launch in Makeup, as M·A·C aims to extend its winning streak in innovation. Indeed, all our billion-dollar-plus brands have exciting newness ahead in both product and commercial innovation as they leverage their brand equity, scale, and omnichannel beauty advisors.

Clinique, the number one prestige skin care brand in the US, pioneered dermatologist-developed products when it was founded in 1968. The brand is deepening its connections with dermatologists, adding powerful instant and dermatologist-level claims, doubling down in its unique safety philosophy, and activating more derm education on TikTok. And later this month, Clinique will elevate its equity in de-aging with a breakthrough launch of Smart Clinical Repair Lifting Face and Neck Cream, a new dermatologist-tested formula.

Estée Lauder, among the biggest prestige brands globally, is expanding its world-renowned Advanced Night Repair franchise with the launch of Rescue Solution for Sensitive Skin. And the brand's luxury-oriented Re-Nutriv franchise has a rich innovation program across Makeup and Skin Care.

La Mer, the global leader in luxury skin care, grew double digit in Asia/Pacific in fiscal year 2023 and aims to accelerate its growth with the upcoming launch of the Lifting/Firming Serum. This launch capitalizes on La Mer's successfully upgraded The Moisturizing Soft Cream as both bring advanced benefit in anti-aging efficacy. Moreover, La Mer is introducing new regimens focused on the power of its iconic Miracle Broth to capitalize on the trend of night regimens.

In fiscal year 2024, this esteemed tier of billion-dollar-plus brands is set to expand its [ph] brands (00:09:32) count by 50%, as we expect Jo Malone London and TOM FORD to cross the sales threshold. These two brands have excelled over the last decade and are ideally positioned for the next decade, given their positioning in the fast-growing segment of luxury and artisanal fragrance.

For TOM FORD, which epitomize luxury glamor, fiscal year 2023 was monumental. We are thrilled to have acquired a brand after having collaborated to create TOM FORD for over 15 years. This acquisition is a central building block to realize our aspirations in high-growth luxury and couture beauty.

Moreover, the brand sales rose strong double digits organically in Fragrance for the fiscal year. The breadth of this performance was stunning, as over 30 markets grew double digits. The strength of its hero products and innovation proven a powerful combination with new and existing consumers, and TOM FORD enticing Café Rose launched to begin fiscal year 2024. In Makeup, TOM FORD delivered double-digit organic sales growth in Asia/Pacific and the markets in EMEA, driven by excellent performance in lips.

Among our other scaling brands or those with sales between \$500 million and \$1 billion, we are encouraged by their progress in fiscal year 2023. For Bobbi Brown Cosmetics, the brand continued to complement its expanding Makeup business with strong growth in Skin Care, while Aveda executed on its global ambition with the successful launch in mainland China.

The Ordinary graduated into our tier of scaling brands, as double-digit sales growth propelled it well above \$500 million. The brand's list of achievements for the year is long, indeed, from success in its hero product to a step change in the contribution to sales from innovation to doubling its TikTok followers to strong share gains in prestige skin care in the US and Western Europe, The Ordinary proved its high-performance, ingredient-led products are well loved and we believe it is just getting started in realizing its global potential.

Looking across our developing brands, in which we strategically invest to realize the scaling brands of the future, Le Labo, KILIAN PARIS, and Editions de Parfums Frédéric Malle, each achieved double-digit organic sales growth in fiscal year 2023 to continue their winning streaks. Impressively, over the last five years, these three brands have delivered over 30% compound annual growth demonstrating brand building acumen.

At this time next year, we will be on the verge of launching BALMAIN Beauty with the namesakes luxury fashion house. Our collaboration with BALMAIN has been exceptional and we cannot wait to introduce this new luxury beauty brand to the world.

For our brand portfolio, we have positioned ourselves to take advantage of the efficiency, the effectiveness that will be enabled by generative AI. Furthermore, creating high-quality, high-performing products is in our DNA. Innovation has long served as a catalyst for growth and, once again, represented over 25% of our sales in fiscal year 2023. We have a rich pipeline of newness slated for fiscal year 2024 and it gets even bigger and stronger in fiscal year 2025 with more breakthrough innovation and expansion into white space opportunities.

Over the last few years, aligned with our innovation strategy, we have significantly increased the breadth, depth, and diversity of our clinical studies for new and legacy products across categories to deliver impactful claims. This work, combined with our newly opened China Innovation Labs in Shanghai, it keeps us with even greater capabilities to drive growth with consumers locally and around the world.

For Skin Care, we have also significantly increased our scientific [ph] credentialing (00:13:58), demonstrated by an 85% increase in scientific advisory board members and third-party dermatologists and academic partners in the last two years. Last month, at the World Congress of Dermatology in Singapore, we presented several studies for Clinique, Estée Lauder, and La Mer.

This was a milestone moment for Estée Lauder's Re-Nutriv franchise, as our scientists unveiled our newness breakthrough longevity age reversal research on a global stage. Re-Nutriv has been and continue to be a pioneer in this frontier of skin biology and will extend upon the recent success of Ultimate Diamond Transformative Brilliance Serum with compelling innovation this fiscal year.

As we rebuild from the challenges of fiscal year 2023, we expect to leverage and extend upon these strengths as we drive resilient growth. The opportunities ahead of us are significant, as over 900 million people are expected to enter the middle class through 2030 and drive consumption as they seek the high quality, strong efficacy and joy that prestige beauty affords.

Our company has great confidence in the long-term development of China and we are proud of the very strong business we have built, led by our exceptional local team. The Chinese consumers continue to be the unrivaled number one growth drivers of our industry throughout the decade.

We are pleased to have returned to organic sales growth in mainland China this fiscal year 2023 and to have expanded our prestige beauty share, as the market gradually evolves in its recovery from the pandemic. Impressively, mainland China's fourth quarter organic sales were up double digit compared to both one and two years ago, and we further expanded our prestige beauty share in the quarter.

We made significant long-term investment in the market across fiscal year 2023. Beyond the opening of the China Innovation Lab in Shanghai and a new distribution center in Guangzhou, we launched Aveda to start the year and Le Labo to end the year. Aveda quickly captured up the ranks of prestige hair care, driven in part by its focus on the skinification of hair and high-performance product for scalp care. Le Labo initial freestanding store in Shanghai redefines experiential shopping, which makes it no surprise that it was the brand's top-performing store in the world in the month of June.

We also invested in the vibrant opportunity in both brick-and-mortar and online, opening in seven new cities, expanding our online reach with Douyin, and creating exceptional live streaming content which, as you know, is a game changer to excel in the market. Our online ecosystem continues to move from strength to strength across social and commerce, encompassing Tmall, JD, WeChat, RED, and Douyin, among others, driving our share gains for the fiscal quarter and year.

Online in mainland China performed exceptionally well every months in the fourth quarter to realize over 60% organic sales growth and expand online prestige beauty share by 2 points, [ph] owing (00:17:41) to innovation, gifting campaigns, and excellent execution. We capped the quarter's success on 6.18 where our brand strength was broad based. Estée Lauder ranked number one in store live streaming prestige beauty on both Tmall and Douyin. La Mer ranked number one in lux beauty on Tmall for the third consecutive year, and Jo Malone London took the top spot on Tmall and JD for lux fragrances.

From an organizational standpoint, mainland China and China travel retail have announced their capabilities for local coordination of go-to-market strategies and plans to maximize long-term value and support brand equity. The expected growth of the middle class around the world is exciting implication for our business given also our vibrant emerging market portfolio. Indeed, in fiscal year 2023, our emerging markets delivered organic sales growth of 20%, led by India, Brazil, Turkey, and Thailand. India grew nearly 50% for the year, driven by excellent performance by our long-standing brands in the market and the very successful launch of The Ordinary.

In North America, we have focused on re-accelerating growth to better capture prestige beauty opportunities in the region. Our multi-facet strategy plan includes launching a robust innovation pipeline, increasing engagement by brands on TikTok, accentuating our strength in luxury and artisanal fragrance, and high-performance, ingredient-led Skin Care, an expanding brand reach in specialty multi, among other initiatives. And we are excited to extend our reach online as The Ordinary and Estée Lauder are soon to launch on TikTok Shop.

Let me now turn to our profitability. We have identified four building blocks to progressively expand adjusted operating margin over the next few years. First, we are focused on optimizing mix by elevating luxury across brands, driven by consumer preferences and by expanding our direct-to-consumer ecosystem across brick-and-mortar and online.

Second, we see many opportunity to maximize value through better price realization and accretive innovation. Third, we intend to increasingly leverage the strategic investment we have made over the last few years, most notably, our new manufacturing facility in Japan and expanded online capabilities. Last, we believe we can unlock meaningful cost efficiencies in our value chain, as we complete the rollout and adoption of our new integrated business planning process across the global operation and use generative AI to drive efficiencies.

In closing, while we had a challenging year, we remain confident in our long-term strategy to realize the promising growth opportunity in global prestige beauty with our diversified portfolio brands, robust research and development capability, and global reach. We are encouraged by the fundamental strengths of our business in the markets of EMEA, Asia/Pacific, Latin America, and are focused on our plans to recover growth in Asia travel retail and North America.

For fiscal year 2024, we believe we are well positioned to return to organic sales growth and improve profitability. To our employees, you are the heart and the soul of our beautiful company, and I extend my deepest gratitude to your exceptional contribution and dedication.

And now, I will turn the call over to Tracey.

Tracey Thomas Travis

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

Thank you, Fabrizio, and hello everyone. While we certainly had many successes this past fiscal year, as you just heard, we are not satisfied with our fiscal 2023 financial results and are executing on our strategy to progressively rebuild the margin-accretive areas of our business over the next few years and leverage the investments we have made in manufacturing, distribution, and technology capabilities. I will further address our plans when I discuss our fiscal 2024 outlook, but first I will cover the fiscal 2023 fourth quarter and full year results.

Our fourth quarter organic net sales increased 4% and earnings per share was \$0.07. From a geographic standpoint, organic net sales grew in nearly all markets in both Asia/Pacific and EMEA. This strong performance was partially offset by the ongoing challenges in our Asia travel retail business, as we expected.

Organic net sales in Asia/Pacific rose 36%, reflecting double-digit growth in most markets, led by mainland China and Hong Kong SAR, as they continued to progress in recovery with fewer COVID-related restrictions compared to the prior year. They also benefited from our successful brand innovations, new product launches, activation of consumers, and targeted consumer reach. In mainland China, online realized over 30% organic growth and achieved approximately 60% penetration of sales in the quarter.

In EMEA, organic net sales decreased 15%. The growth in nearly all markets and channels of distribution was more than offset by the performance of our Asia travel retail business. In Hainan, retail sales declined more than we expected in the quarter for the reasons Fabrizio mentioned. Excluding our travel retail business, net sales in both Makeup and Fragrance rose double digits in the region, benefiting from our strategic investments in advertising and promotional activities and the reestablishment of services in our stores.

Organic net sales in the Americas were flat compared to last year. The strong double-digit increase in Latin America, driven by the re-acceleration of Makeup growth in Brazil and Mexico, was offset by the decline in the United States due to the slower-than-expected pace of improvement in retail sales of several of our brands. Standout performance from The Ordinary continues to be a bright spot in the region for the many reasons that Fabrizio mentioned earlier.

From a product category perspective, Makeup organic net sales increased 13%, reflecting growth in each region, led by Asia/Pacific as recovery continued and usage occasions increased. M·A·C, Estée Lauder, and TOM FORD drove growth, benefiting from investments in brand activations and increases in in-store staffing, the continued success of hero products, as well as new product launches.

Fragrance organic net sales rose 12%, led by Le Labo and TOM FORD. Strong double-digit growth from Le Labo reflected increases in every region, momentum from our City Exclusive special collection, as well as growth from both existing and new points of distribution, including its expansion into mainland China. The increase from TOM FORD was fueled by strategic investments in advertising and promotional activities to support key shopping moments and brand activations.

Organic net sales increased 6% in Hair Care and declined 3% in Skin Care. The pressures in our Asia travel retail business drove the Skin Care decline and were largely offset by the exceptional growth in the Asia/Pacific region. La Mer and Estée Lauder declined, while The Ordinary, Bobbi Brown, and M·A·C grew. M·A·C's growth was driven by the launch of the Hyper Real line of skin care products.

Our gross margin declined 330 basis points compared to last year. This decline primarily reflects the under-absorption of overhead in our plants due to the pull-down of production throughout the year, given our elevated inventory levels as well as increased obsolescence charges. Operating expenses increased 70 basis points as a percent of sales, driven largely by the increase in advertising and promotional activities to support commercial activations in the quarter.

Operating income declined 66% to \$71 million, and our operating margin contracted 380 basis points to 2% in the quarter. Our effective tax rate for the quarter was a negative 17.9% compared to 14.2% last year due to a true-up in the quarter to reflect the final effective tax rate for the fiscal 2023 full year.

Diluted EPS of \$0.07 decreased 82% compared to last year. The impact from foreign currency translation and foreign currency transactions in key travel retail locations negatively impacted EPS by 7% and 9%, respectively.

As we discussed in May, we completed the acquisition of the TOM FORD brand and the related intellectual property on April 28, paying approximately \$2.3 billion. As a result of this acquisition, we entered into arrangements to license the TOM FORD trademark for eyewear to Marcolin and fashion to Zegna, which were the brand's prior licensees, creating a new revenue stream for the company. This acquisition had a dilutive impact to EPS of \$0.01, including interest expense and our debt financing and reflecting savings from royalties we no longer have to pay.

Shifting now to our full-year results, this has certainly been a more volatile year than we anticipated. The challenges to our business in Asia travel retail and the United States, as well as in the first half in mainland China were partially offset by the progression of recovery everywhere else.

In mainland China, we continued to gain share in all major product categories, demonstrating the strong demand for our products, although we remain conscious of the evolving economic conditions. And overall, our investments in brand activations, increased in-store staffing, distribution expansion, and online capability aided in the acceleration of recovery of sales, which largely occurred in brick-and-mortar channels excluding travel retail.

Net sales growth was strong in brick-and-mortar, particularly in our freestanding stores and with our specialty multi retailers. Global travel retail represented 20% of our reported sales in fiscal 2023, and online net sales which

were flat represented 29% of our reported sales. Organic net sales fell 6%, primarily reflecting the challenges in our Asia travel retail business, which drove the declines in our EMEA region of 16% and in Skin Care of 14%.

Nearly all other domestic markets in EMEA grew double digits. In Asia/Pacific, net sales rose 4%, as markets continued to progress in recovery throughout the year and benefited from investments in advertising and promotional activities, innovation, and distribution expansion. Net sales in the Americas was flat compared to last year.

Regarding categories, Fragrance net sales increased 14%, rising double digits in every geographic region and benefiting from the continued strength of hero products, successful innovation, and distribution expansion, while Skin Care was more challenged in Asia travel retail and North America. Net sales grew 6% in Hair Care and was flat in Makeup.

Our gross margin declined 440 basis points compared to last year, largely due to the slower-than-expected recovery in Asia travel retail. This includes higher obsolescence charges, under-absorption of overhead in our plants due to the pull-down of production throughout the year given our higher inventory levels, and less favorable category mix from our Skin Care mix.

Operating expenses increased 390 basis points to 59.9% of sales, driven primarily by the decline in sales. Despite the pressures to sales, we sustained our investments to support markets where recovery was evident, including in areas such as advertising, promotion, innovation, and selling, which collectively increased by 280 basis points as a percent of sales.

Operating income declined 48% to \$1.8 billion from \$3.5 billion last year, and our operating margin contracted 830 basis points to 11.4% for the full year. In spite of the challenges that materially impacted our top line growth, we continued certain of our strategic investments important to support recovery and drive long-term sales growth and profitability.

Our effective tax rate for the year was 26.5% compared to 21.3% last year, primarily reflecting the change in our geographical mix of earnings. Net sales declined 53% to \$1.2 billion, and diluted EPS of \$3.46 decreased 52% compared to last year, including the dilutive impacts from foreign currency translation and foreign currency transactions in key travel retail locations of 4% each. The acquisition of the TOM FORD brand was dilutive to EPS by \$0.01.

Now, turning to our cash flows for the fiscal year, we generated \$1.7 billion in net cash flows from operating activities compared to \$3 billion last year. The decrease reflects lower net income, partially offset by lower working capital. We invested \$1 billion in capital expenditures for supply chain enhancements, including our new manufacturing facility in Japan, consumer-facing capital such as distribution expansion, investments in existing counters, and online capabilities.

We returned \$1.2 billion in cash to stockholders through both dividends and share repurchases. Beginning in December of 2022, we suspended the repurchase of shares given the increase in debt due to the TOM FORD acquisition.

Before I turn to our outlook for the full year, I want to take a moment to first address the recent cybersecurity incident we disclosed in July involving an unauthorized third party that gained access to some of our systems. After becoming aware of the incident, we proactively took down some of our systems. We began bringing our

systems back online within days, which limited the incident's impact on the company's operations. Based on the information available to date, we believe the incident is contained.

So, now, let's turn to our outlook. This past year has undoubtedly been difficult, largely given the challenges we faced from increased market volatility in certain markets and the corresponding impact on our business. As we work to return to net sales growth in fiscal 2024 and over the next few years progressively rebuild our operating margin, we remain focused on the transition of key areas of our business that have been disproportionately impacted by a slower pace of recovery, while also continuing to support growth in those areas where the recovery is more advanced.

Over the next few years, mainland China and our travel retail business are expected to remain key drivers of our long-term profitable growth and we anticipate continued growth with other areas of our business, including emerging markets globally, our more mature markets in the West, and our direct-to-consumer channels globally. Assuming an eventual return to global prestige growth of 4% to 5%, we expect to return to more consistent compounded annual sales growth within our 6% to 8% long-term growth algorithm.

Restoration of our operating margin is a top priority, though margin recovery will not happen in one year. We do, however, expect to progressively drive margin expansion, as we return to profitable growth in Skin Care, improve Makeup margins, and continue to drive our momentum in Fragrance, particularly our high-end artisanal fragrance brands.

In addition, we plan to expand our gross margin through continuing to leverage our prestige pricing power inclusive of driving additional accretive and compelling innovation and improvements in operational efficiencies, including enhanced supply/demand planning and inventory optimization to reduce excess inventory and discounts. We will begin to leverage the further regionalization of our manufacturing and distribution network in Asia to create greater inventory agility as demand fluctuates.

Overall, beginning in fiscal 2024, we expect to recapture lost operating margin overall – I'm sorry, beyond fiscal 2024, we expect to recapture lost operating margin at an accelerated pace by delivering annual margin expansion that is faster than our pre-pandemic historical average. This acceleration is expected to become more evident after the first quarter of fiscal 2024.

So, turning to fiscal 2024, we expect to continue to deliver net sales gains in the areas that performed well in 2023, including Asia/Pacific, our Western and emerging European markets, and Latin America as they continue to progress in recovery from the pandemic and benefit from the strategic actions we are taking to accelerate growth, including targeted consumer activation, compelling innovation, and distribution enhancements that we drove throughout the pandemic period.

We are, however, mindful of the macroeconomic headwinds that have emerged in China's economy. This has also resulted in our Asia travel retail business taking a bit longer than we originally anticipated to return to growth, as travel and conversion remain pressured which has been exacerbated by the sudden reduction of sales to non-travelers relative to the return of individual travelers in Korea and in Hainan.

Correspondingly, inventory levels in the trade and Asia travel retail have improved at a slower pace. This will create greater pressure on our first half as we expect to continue to both adjust our shipments and increase our retail activations, but also should yield sequential quarterly improvements throughout the year in both sales and margin.

With that backdrop in mind and using June 30 spot rates of [ph] \$1.087 for the euro, \$1.261 for the pound, CNY 7.253 for the Chinese yuan, and KRW 1,321 (00:38:14-00:38:21) for the Korean won, the full fiscal year organic net sales are forecasted to grow 6% to 8%. Royalty revenue from the acquisition of the TOM FORD brand is not expected to be material to net sales growth and will be excluded from organic net sales until the fourth quarter. The cybersecurity incident is also not expected to have a material impact to net sales. Currency translation is expected to dilute reported sales growth for the full fiscal year by 1 percentage point.

We take the majority of our pricing actions at the beginning of our fiscal year. Our strategic price increases, including new products, are expected to add approximately 5 points of growth. We expect the net benefits from strategic pricing, discount reductions, and lower obsolescence to drive gross margin expansion for the full year, partially offset by manufacturing under-absorption.

We are aligning our production volumes to address a more variable demand environment with the intent to carry less inventory in our system and in the trade, while we continue to regionalize our supply base in Asia. However, we expect the lower mix of net sales from the highly margin-accretive areas of our business, including Asia travel retail and Skin Care, and the under-absorption of overhead to result in margin contraction in the first half of the year. This is expected to be more than offset by gross margin expansion in the second half of the year, given the greater mix of our travel retail business and Skin Care and less obsolescence charges compared to last year.

Our full-year operating margin is forecasted to be approximately 12.0% to 12.5%, a 60 to 110 basis point expansion from fiscal 2023. In fiscal 2024, we anticipate sequential margin expansion throughout the year, driven by improvements in gross margin, while also maintaining go-to-market initiatives where appropriate. We expect our full-year effective tax rate to be approximately 27%.

Diluted EPS is expected to range between \$3.50 and \$3.75 before restructuring and other charges. The cybersecurity incident is expected to be approximately \$0.07 dilutive to EPS. Our EPS range also includes approximately \$0.11 of dilution from currency translation. In constant currency, we expect EPS to grow by approximately 4% to 12%.

Net cash flows from operating activities are forecasted between \$1.7 billion and \$1.8 billion. Capital expenditures are planned at approximately 6% of forecasted net sales, as we expect to fund new distribution and online capabilities, further enhance our manufacturing and distribution network, including the completion of our first manufacturing facility in Asia located in Japan to support the development of our Asia/Pacific region. We also plan to continue investing in information technology to support our business.

Our fiscal 2024 outlook also assumes flat quarterly dividends and the continued suspension of our share repurchases, as we focus on deleveraging after the TOM FORD acquisition and prepare for the payment to purchase the remaining outstanding equity interest in DECIEM anticipated in May of 2024. For our first quarter, we currently expect organic net sales to fall 12% to 10%. The cybersecurity incident is not expected to have a material impact to net sales.

At this time, we expect first quarter diluted EPS of negative \$0.31 to negative \$0.21 before restructuring and other charges. The cybersecurity incident is expected to be approximately \$0.07 dilutive to EPS. This also includes approximately \$0.02 of dilution from currency translation. In constant currency, we expect EPS of negative \$0.29 to negative \$0.19.

I would like to close by thanking our employees for their dedication and focus during what turned out to be a challenging year. While we are not satisfied with our performance overall, we are certainly pleased by the results

we were able to deliver in many recovering markets and brands. For fiscal 2024, we believe we have the right plans to navigate the environment, as we gradually return to our historical cadence of long-term progressive and sustainable sales and profit growth, fueled by our highly desirable brand portfolio and our incredibly talented employees.

And that concludes our prepared remarks. We'll be happy to take your questions at this time.

QUESTION AND ANSWER SECTION

Operator: The floor is now open for questions. [Operator Instructions] Our first question today comes from Steve Powers from Deutsche Bank. Please go ahead.

Steve Powers

Analyst, Deutsche Bank Securities, Inc.

Q

Yes, hey, good morning, and thank you. I'd love it if you could address two topics. Maybe one for you, Tracey; one for you, Fabrizio. First, for Tracey, just appreciate your commentary at the end there, but just maybe a little bit more detail if you could expand on the assumptions embedded in the 1Q setback and declines juxtaposed against what looks like a pretty rapid return to fairly – to basically the double-digit organic growth over the remainder of the year. Just a little more color there, and I'm assuming a lot of the variability is focused on Hainan, so maybe some expansion there.

And then, Fabrizio, I know the company had a leadership off-site in June. I'd love your perspective on how recent changes in the operating environment impacted points of emphasis of that meeting and how the related discussion may have informed your 2024 outlook. Thank you very much.

Tracey Thomas Travis

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

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Hi, Steve. So, I'll start with your question regarding the cadence of the year, and you're right, there is a lot of variability. If I would take you back to the first and second quarter of last year, you'll recall that while we had some disruption in Hainan, we did have – we still had some business in Hainan. We also had business in Korea. So, our travel retail percent of mix was higher in the first half of last year, in addition to obviously the recovery that we were seeing in the EMEA and Americas regions in terms of the airports in those regions.

In the second half of the year, then obviously, we saw the challenges that we've called out certainly in the last call as it relates to both Korea and obviously what Fabrizio talked about in the fourth quarter as it relates to Hainan. We have a bit of a reverse situation as we're anniversary those impacts this year. So, with what happened in the May-June timeframe in Hainan, we are seeing less traffic and less conversion in Hainan than we saw previously.

That is impacting our Q1 certainly compared to last year when we saw more traffic and more conversion in Hainan and in Korea. That gets a bit better in Q2 as we anniversary some of the softness that began to materialize in Q2 last year in those two areas. And then we're anniversary, obviously, the softness that we experienced in the second half of our fiscal 2023 in fiscal 2024. So, we are expecting that travel retail will get progressively better in the third and fourth quarter, certainly, compared to the third and fourth quarter we had this year.

Part of that, Steve, is obviously the destocking that we are doing. So, in Hainan, obviously, with the sudden change in daigou, that is making the retail traffic slower than what we had anticipated. And as a result of that, it's changing our view on the shipments that we will need for Hainan in the first quarter and certainly a bit into the second quarter.

So, I hope that helps in terms of some of the cadence of what we're experiencing and why the margin differential is so great. As you know, travel retail certainly benefits from a lot of the investment that we make in our markets like China and Korea and Japan and all of the other markets not only in Asia, but in EMEA as well. And so, it is a higher-margin channel for us for some of those reasons.

Fabrizio?

Fabrizio Freda

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

A

Yeah, on our leadership [audio gap] (00:47:58) June, we really look at the strategy and the strategy of the future. And so, what Tracey and I have presented in our prepared remarks are the results of also this work of reconfirming the strategy for 2024 for the next three years.

And so, what are the key takeaways was your question is that, first of all, that the market of global prestige beauty continue to be very attractive and will continue to be more and more attractive in the future. And our strategy is, as I explained in the prepared remarks, is now focused on continue building on our strengths and continue building the areas where we are really delivering great results and supporting this growth.

At the same time, continue reinforcing the health of our brands and the innovation of our brands and refocusing resources and activities in all these areas and then fix the TR issue, including a much better coordination between TR organization in China and China region organization in mainland, and the plans for the North America acceleration and to continue winning emerging markets. By the way, in the last quarter we're astonishing with a 38% growth. And so, deploying the resources, the capabilities, the skills to continue doing this in the key emerging markets, I have to say the excitement in India is particularly high.

And so, in summary, the leadership of the company has agreed and allocate resources and skills on the key components of the strategy for the next three years, which is leverage the growth of the market and obviously continue to build our strength, fix our issues and most importantly, support the profit recovery plan that again we explained in the prepared remarks in every single aspect at accelerated pace of profit recovery, as Tracey just explained.

Operator: The next question comes from Dara Mohsenian from Morgan Stanley. Please go ahead.

Dara Mohsenian

Analyst, Morgan Stanley & Co. LLC

Q

Hi, guys. So, a two-part question on my end that I think builds on that answer, Fabrizio. Some fairly unique circumstances in the past year, both externally and internally that caused weaker results than you originally expected. That's uncharacteristic versus a longer-term track record.

So, just wanted to get your perspective on, A, if you think you have good visibility on this fiscal 2024 earnings guidance, how much investment are you assuming incrementally to drive a recovery post-2024; and then, B, perhaps, Tracey, you gave us some detail on margin expectations, but how should we think about sort of the

ability to get back to peak historical margins at some point over the next few years and how quickly we might see margin recovery relative to this 2024 base just as we think about those four building blocks you mentioned from here? Thanks.

Fabrizio Freda

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

A

Yeah. In term of the visibility to the guidance, obviously if Tracey and I had given you this guidance, we believe that that's the – in this moment is the projector of the business. So, we have visibility and clarity in term of our plans.

I want, however, to underline that the volatility externally remain very, very high, particularly the volatility in the Chinese market, the volatility in the transition in the TR market from the daigou to the regular travelers, the transition to the groups traveling. They've just been announced in term of [ph] low (00:51:53). The transition, obviously, on the judgment of what the economy recovery will be globally in the post-pandemic environment, particularly how the economy in China will evolve. So, all these external elements are part, obviously – or assumptions of these external elements are part of our guidance, and in the press release, we made an effort to explain all our assumptions in the guidance.

And in term of our internal plans and in term of the continued leveraging our current trends on the things which are working, we are pretty confident. The real question is how fast we will be fixing the issues, but the strengths of the current trends are what is working, are frankly more easy to predict and to forecast. So, net, we believe in our guidance, but will be obviously volatility to be managed in the context of the future and you will see as much as we will see the evolution in these areas.

And then, Tracey?

Tracey Thomas Travis

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

A

Yeah, Dara. So, I mean, certainly we are encouraged by some of the signs we see, recent signs that we see in terms of recovery. The return of travelers. We are, as Fabrizio mentioned in terms of our fiscal 2024, taking actions to pretty dramatically pull back on some of our production, so that we can get our inventory levels in line, and that will improve our margin, and I've talked about in my prepared remarks that we're expecting gross margin recovery from some of those actions.

As the situation normalizes and more travelers come back to travel retail, we are very confident in the strategy that we've had previously. Pre-pandemic, we were well on our way to those 20% operating margins. We don't see any reason why once things normalize that we can't get back to those 20% margins.

Timing, I can't give you. I have said in our prepared remarks that we certainly over the next few years have plans to accelerate the margin progression well above our historical guidance of 50 basis points of margin improvement, and that does recommend – or that does represent a catch-up in margin progression and, again, the strategies that we have to do that. But we are incredibly focused as an organization on returning to the margins that are more representative of our growth and our growth potential.

I will also underscore the fact that we will not do that at the expense, at the short-term expense of hurting our brands or hurting our markets that are in recovery. So, it is a balancing act for us in terms of making sure we're making the right surgical investments that support not only the recovery and the markets that are further along in

recovery and as well as the long-term investments that we need to continue our growth algorithm of 6% to 8% top line growth and margin expansion.

So, again, I can't – I know that's not the answer you're looking for in terms of you want a specific year and a specific number, and hopefully we will be able to give that to you when we get a bit more clarity on more stabilization in the environment. But right now, you have the commitment of our entire organization that we recognize and have plans to accelerate our margin progression well beyond our historical levels in order to try to catch up.

Operator: Our next question comes from Chris Carey from Wells Fargo Securities. Please go ahead.

Chris Carey

Analyst, Wells Fargo Securities LLC

Hi. Good morning everyone.

Q

Fabrizio Freda

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

Good morning.

A

Chris Carey

Analyst, Wells Fargo Securities LLC

So, just one quick follow-up, and then kind of a geographic question. Just on the China travel retail inventory dynamic, Fabrizio, you had mentioned that there's going to be greater collaboration between your teams in mainland and China travel retail. What's your confidence that some of the things that you may need to do to invest behind clearing inventory won't impact brand equities and brand health? And I'm basically just trying to get a sense of the types of actions that you might be taking to clear inventory if consumption trends are as volatile as you say.

Q

And then just the geographic question would be, you had mentioned quite impressive growth rates in India, but also some underperformance in North America. Just over the next 12 months or longer, how do you think about this non-Asia market progressing with perhaps to touch on what you see in some of these newer, faster growth markets? Thanks so much.

Fabrizio Freda

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

Yeah. So, I mean, in term of the travel retail issue, you described it well. So, we have increased the collaboration between the local team and the TR team just to have not only better common decision making on the key prioritization on the balancing act in order to create value and in order to continue develop brand equities in a more coordinated way.

A

But we also have more analytics to understand the channel dynamics, the pricing differentials, and all the things. So, we have created the base of much more information and timely information to take the right decisions in coordination. So, this is a big improvement that should reduce the risk of non-coordinated actions in the future.

Then, the brand health that you also mention, I want to underline, the brand health is evident from the results in China. The brand health with the Chinese consumers is really strong and we have good market share results

which we already mention. The business has been growing 36% in the April-June quarter. The online market share has been extremely strong, 2 points extra of online market share.

Our activation and consumer passion for our brands has been further confirmed by external research that our brands are at the top of the ranking of [ph] desirable (00:59:04) brands in the market. So, the brand equity, the brand health, also thanks the extraordinary work of our mainland region, China mainland region team is in good shape.

And then you said correctly that we are very focused on the sell-through of the stocks, [ph] so two favorite (00:59:25) stocks, obviously, as Tracey has explained, in May-June, Hainan was relatively weak and that's why there is an impact also on the first quarter trend. But we are very focused on creating the retail activities that will facilitate the sell-through, and that's the key focus of the team. So, in that area, we are very aligned, we have the organizational resources squared and we are focused on all these issues, very squared.

On the second part of your question is, if I can give you light on the other markets. I mean the – I hope that the report is very clear. The rest of our business, ex the TR Asia, has been growing in the last quarter 17%. This is one of our fastest growth rate ever, despite North America flat. And so, we have really undergoing strengths in all the rest of our business, which is the results of all the brand strengths which I explained in the prepared remarks.

So, we have four very big brands, well above billion-dollars brands, and we will add two more. So, to be clear, we will be a company by the end of 2024 with six billion-dollar brands, extraordinary scale in the global system and global reach. So, this is behind our strengths. Then I wanted to underline the strengths of our innovation. Our innovation is strong, is also in tough challenging year like 2023 remains at 25% and the innovation pipeline for 2024 and 2025 is very, very strong, particularly in 2025, we have some extra white spaces innovation, which are very promising. So, this also will support the continued strengths of this other part of the business – other regions as you mentioned.

And then finally, the execution in this region has been stepping up because we explained that as the recovery from the pandemic progress, our ability to execute in the post-pandemic world has been developed and is getting better and better months after months. So, in the regions which have been faster in the post-pandemic development, we have been faster in recovery and great execution and great results. So, this will continue to progress in 2024. So, we have good confidence on that.

On the US, where on the contrary we said there is work to be done, the team is very focused on doing this work. We have very clear plan. Again, I summarized them in the prepared remarks, but to go back to them, our strategy in rebuilding the North America growth [ph] has really various – lists (01:02:20) four big building blocks. The first one is a very rich pipeline of newness which is later in 2024 and further reinforced in 2025, focused on breakthrough innovation on new claims that will help also unlocking the consumers in online and in special multi more aggressively.

We are driving higher EMV to our investment in various platform, including TikTok or especially TikTok. We are focused on strategic pricing to drive value per unit in correct way, and we will continue to recruit for mass with very strong activities, also commercial activities which are focused on this in support in the – with the support of our retailers which are very aligned on this front. And our high-touch services are continue to evolving, particularly online with new technology and new activities.

So, I also want to underline that in North America, our business of M·A·C, our business of Clinique, our business of The Ordinary, so the entry price points brands is particularly important. The scale in North America in our

business is the entry price point brands. And all these brands have very exciting brand-by-brand plan and then the opportunity in luxury fragrances is extraordinary.

[ph] And I think (01:03:42) you have seen the strengths of luxury fragranciness around the world and now we will further leverage also in North America as the next steps. Keep in mind that in the luxury fragrance part of our portfolio, in the last 10 quarters in a row at double-digit growth or more, despite North America has not yet fully leveraged these potential engines. So, this will be another big addition as of 2024.

Operator: Our next question comes from Bryan Spillane from Bank of America. Please go ahead.

Bryan D. Spillane

Analyst, Bank of America

Q

Thanks, operator. Good morning everyone. I just have one question, and I think you've touched on it a couple of times in both the prepared remarks and the press release. It was just what's happening in Hainan with the daigou and kind of the reseller market.

So, can you just – as you're looking forward, is your expectation that it really – that travel retail in Hainan specifically becomes really just more selling to individuals and that the daigou piece will be a lot smaller or maybe not even much of an element at all going forward? And if that's true, just how that changes how you're approaching operating in China now. Kind of where do you make up those sales if you don't have as big a presence with daigou?

Tracey Thomas Travis

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

A

So, I'll start in terms of that question. We don't control it, right? We sell to our travel retail operators. And so, the whole mix of who is buying in Hainan is really with our retail partners.

Part of the adjustment that we are seeing right now is the timing of when regular travelers return to Hainan, when individual travelers, to your point, return to Hainan, and some of the changes in enforcement and regulations that have happened in China. And so, there was a disconnect in timing that certainly is impacting our sales combined with the fact that we are reducing the inventory levels that we have in Hainan. So, that is all having a disproportionate effect.

I think when we look at the development that has been done in Hainan, and we've talked about this for several years, our expectation is that travelers, regular individual travelers will return to Hainan and they will enjoy the fantastic shopping experience that's been created in Hainan and we have no concerns whatsoever about travel retail growing with traveling consumers.

It's a timing issue for us right now. And so, I just wanted to really underscore that. It's a pretty – it's having a timing issue that's having a big short-term temporary impact for us. But we are not concerned at all about what we have shared with you in the past in terms of our strategy to continue to grow travel retail globally and certainly in all of our markets in Asia.

Fabrizio Freda

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

A

Yeah. And I just want to add that we have the clear evidence that when, first of all, the regulations and the retailers decide to focus on individual travelers and when individual travel's traffic becomes strong growing, the

business results are outstanding. Our business in EMEA travel retail in this moment is flying, is a plus, I believe, 36%, plus 40% and the same in the Americas and now the same will start in APAC, in Japan, in Australia, et cetera.

So, wherever there is a post-COVID return to travel, there is a very exciting business growth. And, for example, the groups were allowed so far only in Thailand and in Thailand, this created a very interesting extra sales, although to be clear still below what was in the group since 2019, but there is a recovery trend.

So, the travel retail channel in our opinion remains very, very potential for the long term and this business of selling to the traveling consumer during their travel is an exciting, profitable, equity-building business. What happened during the pandemic when this part of the business was closed has been a temporary distortion that will be rebalanced over time, as Tracey just explained. That is our expectation and our belief.

Operator: Our next question comes from Lauren Lieberman from Barclays. Please go ahead.

Lauren R. Lieberman

Analyst, Barclays Capital, Inc.

Q

Great. Thanks. Good morning. I wanted to talk a little bit about the Japan manufacturing facility and just overall Asia-based supply chain for Asia and just get a little bit more perspective maybe on where you stand, I guess, completion. Is it – and I know you're not going to be able to give us something too specific, but is it by the end of the calendar year, Japan is able to fulfill all of the demand out of China. Just something to help us understand kind of the scale to get that up and running.

And then the implication that has for length of supply chain and then visibility because if you're trying to manage in a more volatile backdrop and even offering what you have on timeline for recovery in Hainan and travelers, are they in Korea and where are they and who are they? You need to be, I guess, more agile and that local supply chain, I would think, would offer a lot of help on that front, but we don't really have a sense of when it becomes a local supply chain, if you will. So, anything you can offer on that front would be really helpful, I think. Thanks.

Tracey Thomas Travis

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

A

Okay. Thanks, Lauren. So, part of the capital that we'll be spending this year is to complete the factory. So, we've done some pre-production runs in fiscal 2023. The factory will be producing a bit of the volume for the region in fiscal 2024. We have very specific plans on which largely Skin Care as we've talked in the past, some foundation products will be manufactured in the plant.

Given where we're at right now, as we just spoke about in terms of Skin Care, that will be more gradual. So, we have to first complete the plant. We also have opened a new temporary distribution center in China. We'll be expanding on some of our distribution footprint in China as well.

So, I would say in terms of – it will take a couple of years of ramp-up before we have the Asia supply chain fully operational and full from a capacity standpoint. That doesn't mean that as we gradually ramp up over this year and next year, we won't be creating more agility by being able to start to shift some of the production in those areas, but right now we're working on contracting some of our production just given some of the shocks to the system.

So, you are absolutely right that long term, this will create agility for us. There are other things that we're doing to create agility. We've talked in the past in terms of some of the investments we've made in technology to help our – especially in a very dynamic demand environment in order to try to forecast more accurately.

I don't know that any forecasting tool would have forecasted what we experienced this past year. But certainly, as we think about all of our new innovation, all of our SKUs, new brands, et cetera, the more that we can technology enable and coordinate our inventory planning and our supply planning, the better we will have from a – experience we will have from an agility standpoint as well. So, there's a tremendous amount of work that is going on to very much improve the situation going forward. Right now we're managing just some tremendous shocks to the system that we're in the process of correcting.

Fabrizio Freda

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

A

And I just wanted to add a bit more color to the concept that Tracey just underlined on the fact that despite this will take a couple of years of ramp-up to get to the full leveraging. The benefits on agility will come as we go earlier. And the reason for that is that the agility is particularly needed on what we call heroes SKUs.

So, the high-volume SKU are the one which can benefit more from speed to market, forecasting decision which are closer to the moment where the market happens, the ability to produce depending on the trends. And so, we will gradually ramp up, but we will ramp up first the SKUs and the brands that have the biggest need to create agility in Asia. And over time, then this will become our, as Tracey described, ongoing in a couple of years, we will have the full agility of the system implement.

Operator: That concludes today's question-and-answer session. If you were unable to join for the entire call, a playback will be available at 1:00 PM Eastern Time today through September 1. To hear a recording of the call, please dial 877-344-7529, passcode #4620398. That concludes today's Estée Lauder conference call. I would like to thank you all for your participation and wish you all a good day.

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