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HNI Corp. (HNI)

Q3 2019 Earnings Call

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Jeffrey Lorenger
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OTHER PARTICIPANTS

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Alessandra Jimenez
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Greg J. Burns
Analyst, Sidoti & Co. LLC

Steven Ramsey
Analyst, Thompson Research Group LLC

MANAGEMENT DISCUSSION SECTION

Operator: Good morning. My name is Rob, and I will be your conference operator today. I would like to welcome everyone to the HNI Corporation Third Quarter Fiscal 2019 Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. [Operator Instructions] As a reminder, today's conference call is being recorded. Thank you.

Mr. Herring, you may begin your conference.

Jack D. Herring
Treasurer, Director of Finance & Investor Relations, HNI Corp.

Thank you. Good morning. I am Jack Herring, Treasurer and Director of Investor Relations for HNI Corporation. Thank you for joining us to discuss our third quarter fiscal 2019 results. Here with me are Jeff Lorenger, President and CEO; and Marshall Bridges, Senior Vice President and CFO.

Copies of our financial news release, earnings presentation and non-GAAP reconciliations are posted on our website. Statements made during this call that are not strictly historical facts are forward-looking statements, which are subject to known and unknown risk. Actual results could differ materially. The earnings presentation posted on our website includes additional factors that could affect actual results. The corporation assumes no obligation to update any forward-looking statements made during the call.

I'm pleased to turn the call over to Mr. Jeff Lorenger.

Jeffrey Lorenger
President, Chief Executive Officer & Director, HNI Corp.

Good morning. We will share our assessment of the third quarter and provide some thoughts on our outlook for the rest of the year. We'll then open up the call for questions. Our teams delivered strong results in the third

quarter. We grew earnings per share 20% and generated our highest quarterly operating profit since 2015. We did this while continuing to confront dynamic market conditions and inflationary pressures. We continue to see a range of demand conditions.

Our supplies-driven office furniture business is showing increased stability. Unlike the first six months of the year, we did not see major demand volatility in the third quarter. That market continues to evolve, but our trajectory is improving. One of the primary drivers of improvement is our e-commerce efforts, which continue to gain momentum and drive profit.

In our contract business, we drove strong third quarter growth with organic sales up 12%. Given our second quarter order momentum and ending backlog, we expected that level of growth. In the mid-August timeframe, we saw small- to midsize project demand soften. This area of the market began seeing delays at an above normal rate. The delays appear to be a reaction to macroeconomic uncertainty, customers taking a wait-and-see approach. Our win rate in this area continues to improve indicating we are competing well. Large projects in day-to-day business have remained relatively strong. In total, we are still expecting fourth quarter contract growth, but it will be at a lower than previously expected.

In hearth, we had a solid quarter. Hearth profit increased 8% on sales growth of 1%. Growth in new construction was partially offset by a small decline in retail products. Both of these businesses are showing positive recent trends. In new construction, we have seen three consecutive months of housing permit growth after eight months of decline. And our retail business is in the midst of its seasonal ramp-up and generating growth. In summary, our teams drove strong profit growth in the third quarter, while dealing with a wide range of conditions.

With that, I will turn it over to Marshall for some additional financial details.

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

Third quarter consolidated organic sales increased 3.1% versus the prior year. Including the impacts of closures and divestitures, sales were up 2.3%. In the office furniture segment, sales increased 3.8% organically. Within office furniture, sales in our supplies-driven business decreased 2% and sales in our contract business were up 12% organically. Hearth segment sales increased 0.9%, new construction grew 2.1% and retail products were down 0.4%.

Non-GAAP net income per diluted share was \$1.08 compared to \$0.90 in the third quarter of 2018. Compared to last year, non-GAAP EBIT increased \$7 million. The benefits from the price realization and productivity net of investments were partially offset by lower sales volume and higher input costs.

Jeff?

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

Thanks, Marshall. We expect to drive profit growth in the fourth quarter despite the slower contract environment I noted earlier. There are two key drivers to the quarter. First, we expect to drive \$6 million to \$8 million of benefit from productivity and cost savings, net of investments. This reflects our team's disciplined approach to driving broad-based improvements.

Second, we are expecting consolidated organic sales to grow in the mid-single-digit range. Similar to the third quarter, we are seeing a range of demand conditions. We expect supplies to grow low-double digits in the fourth quarter due to e-commerce momentum and lower prior year comps. Contract will be slower, but we still expect to generate growth in the low- to mid-single digit range. And finally, we are expecting our retail ramp-up to drive improved hearth results and the fourth quarter sales growth will be in the low- to mid-single digits.

I'll now turn it back to Marshall to provide some additional financial details.

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

Thanks, Jeff. In the interest of clarity, I'm going to provide both our full year outlook and what that outlook implies for the fourth quarter. Our full year forecasted non-GAAP net income per diluted share has narrowed and is now in the range of \$2.50 to \$2.60. This implies non-GAAP EPS of \$1.02 to \$1.12 for the fourth quarter. We now expect full year consolidated organic sales to be up approximately 1%, which assumes fourth quarter consolidated organic growth of 5% to 8%. The impacts of closures and divestitures will reduce growth approximately 100 basis points for the year. And our supplies-driven business, we are expecting sales will be flat to down 1% for the year. This implies low double-digit growth in the fourth quarter.

In our contract office furniture business, we expect full year organic sales will be up 3% to 4% with fourth quarter growth in the low- to mid-single-digit range. In contract, the impacts of closures and divestitures will reduce our full year growth by approximately 300 basis points. In hearth, we expect sales for the year to be up approximately 1%, which implies fourth quarter growth in the low- to mid-single digits.

Jeff?

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

Thanks, Marshall. Our teams continue to manage well, and I would like to thank all of our HNI member owners for their continued commitment and hard work. With those comments complete, I'll open it up for questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] And your first question comes from the line of Matt McCall from Seaport Global. Your line is open.

Matt McCall

Analyst, Seaport Global Securities LLC

Q

Thanks. Good morning, everybody.

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

A

Good morning, Matt.

Matt McCall

Analyst, Seaport Global Securities LLC

Q

So I want to apologize first, I was not able to get in the call until after Jeff spoke, so didn't hear much, so there might be some things that you have to repeat. But I guess, the first one, you talked about kind of the cyclical softness or the macro uncertainty, I think is the way you referenced it. Can you talk about maybe how that's transpired? What's showing up to give you that indication? And then, well, I'll stop there. And then, I got a follow-up on that one.

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

A

Okay. You're talking about contract. I take it, Matt.

Matt McCall

Analyst, Seaport Global Securities LLC

Q

I am, yes.

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

A

But I'll comment on that. Yeah, yeah, yeah. Okay. Yeah, in about mid-August, we started to see what we classify as kind of small- to midsized projects delay at a rate that was 2 times to 3 times our normal rate. We always have some delay, but that was at a higher rate than normal. And if you think about it, we've got a lot of exposure to that. That's historically been one of our main areas. And those projects are more susceptible to uncertainty-driven delays. They're not quite – they're not so large where they're cost-prohibitive, but they're large enough that if businesses want to take a wait-and-see approach when there's some uncertainty, they'll do so.

The day-to-day business has held in reasonably well as customers continue to pursue their daily operating needs. And the larger projects have also continued at relatively normal levels. When you think about the large projects, the longer term cycle of investment required for those makes it more difficult and costly to delay. So what I'd say, Matt, is that started about mid-August. As the quarter has progressed, we have seen some recovery in the small- to midsized projects, though it hasn't returned to the level that it was end of the second quarter, beginning of the third quarter.

Matt McCall

Analyst, Seaport Global Securities LLC

Q

And was there anything – when you think about those projects, any consistency across customers? Was it – I mean, obviously, you're making a broader statement, so there must have been a bit of consistency. But can you talk about maybe end markets, project types, was there anything that was funky about it? Or was it a pretty consistent trend?

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

A

Yes, it was pretty consistent, Matt. I think it wasn't a particular region. We've done a lot of – like I said, we've talked to a lot of our sales forces is heavily engaged. Like I said, our win rate still is strong and improving. It was really kind of across the board, felt like a bit of a pause at that level of project, where I just got the sense businesses were kind of saying, look, we're going to roll with the big stuff because we're committed and the day-to-day business we got to roll on because it's not quite as heavy of a profile investment.

But this next tranche of some of this mid-tier stuff, let's slow down a bit, let's take a wait-and-see approach. It was kind of broad-based and it appears to be macro-driven and the people we've talked to saying, look, we're going to keep a little dry powder here for a bit and see how this develops. And like I said, it's come back some. We're still going to see some growth in the contract business in the fourth quarter. It's just not at the rate it was just given it's one segment of our business.

Matt McCall

Analyst, Seaport Global Securities LLC

Q

And so just to make sure I understand that this is within contract, so when you think about supplies and the trends there, what kind of – I don't know if you kind of compare and contrast to supplies trends with what you just referenced from a contract perspective. Are there any similarities to what you're seeing? I know the project types are different. But are there any things that would lead you to believe that that part of the business is seeing that same type of macro pressure?

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

A

No. Matt, the supplies business, if you recall, it was pretty dynamic early in the year when that – and it's actually stabilized and the order levels, customers seem to be starting about midsummer. We started to see that the early year we had some pullback and now we've started to see that come back. And candidly, it's about what we expected and the fourth quarter looks low double-digit growth. I mean some of that's being driven by e-commerce platform business and some of it's being driven by a lower comparable. But as far as the crossover between the two, they do operate – they do not operate quite differently in many respects.

Matt McCall

Analyst, Seaport Global Securities LLC

Q

Right. And is it to the point where you're enacting plans or efforts to combat the pressures, the macro pressures either top line from a cost perspective? Or is it not to that point yet?

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

A

No, I think – look, Matt, we are always – we're diligent on our broad-based cost initiatives all the time and I wouldn't say it's at that point. We're still investing in the business. We like the platforms we have. We're still seeing growth. And so, no, this isn't – it's not at that point. Like I said, the day-to-day business, even on the contract side, is strong and the large projects are relatively stable as well. So we're not doing anything evasive, put it that way.

Matt McCall

Analyst, Seaport Global Securities LLC

Q

Got it. That's actually really encouraging to hear. So maybe a couple of quick ones, Marshall, can you talk about the price cost environment, overall pricing, any mix impacts, tariffs, just some of the puts and takes from a margin perspective in the quarter?

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

Yeah. For the third quarter, we did have favorable price costs. Matt, I think it really was driven by a little bit softer input costs and some timing related to when those costs hit, including the tariff. So we were approximately \$15 million favorable in the third quarter on price costs. So we are seeing a variety of other factors, but we did increase our profits in the third quarter and also expanded margin.

Matt McCall

Analyst, Seaport Global Securities LLC

Q

And what's baked into the guidance for Q4?

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

Yeah. For the fourth quarter, we're expecting price costs to be positive in the \$8 million and \$9 million range.

Matt McCall

Analyst, Seaport Global Securities LLC

Q

Okay. And then last question I have maybe a jump over to hearth a second. The – maybe give us your updated thoughts, some trends you're seeing, the conversations you're having with some of the builders? What would be your kind of new outlook and your R&R outlook or near-term as we move out to next year?

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

A

Yeah. Matt, I think we're encouraged and the new construction, we're seeing improvements in single family. The last three consecutive positive numbers and permit data. The last eight – following eight months of decline. So we're expecting modest growth in new construction for the fourth. On the retail side, we're seeing an active remodel market, which we expect to translate to nice growth on our retail products business and that's also consisting of what we're hearing from our key channel partners in the market as well.

Matt McCall

Analyst, Seaport Global Securities LLC

Q

Okay. Perfect. Thank you, all.

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

A

Thanks, Matt.

Operator: And your next question comes from the line of Greg Burns from Sidoti. Your line is open.

Greg J. Burns

Analyst, Sidoti & Co. LLC

Q

Hi, just in terms of the \$6 million to \$8 million you're targeting and cost savings for the fourth quarter, you had a number – a \$10 million to \$15 million number for the second half of the year. Is that incremental to that? Or is that part of that \$10 million to \$15 million?

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

Thanks, Greg. No, that's part of it. And as we sit now, we've narrowed that range to \$10 million to \$12 million for the full year and that includes the \$6 million to \$8 million for the fourth quarter.

Greg J. Burns

Analyst, Sidoti & Co. LLC

Q

Okay. Great, thanks. And then in terms of your supplies business, I know maybe a year or two ago, there were some disruptions with the wholesale channel, and you're making investments to fulfill the rightfully quick ship and other things like that. So where do you stand in terms of those investments? Is the supplies business from a go-to-market or customer fulfillment perspective where you wanted to be? Or is there any other kind of improvements you could make on that front? Thank you.

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

A

Yeah, Greg. I think where we're at is we've made those investments and they're delivering as expected. The supplies channel, in general, with the wholesalers is kind of stabilized recently, so we're kind of – we like where we're at, but we're obviously always tuning our model to best meet customers where they want to be met and how they want to be met. And so we did the first tranche, I would say, and we like how that is played out and at the same time, the dynamics in that channel have stabilized. And so we continue to work well with our partners there and to attack the market on both fronts, so to speak.

Greg J. Burns

Analyst, Sidoti & Co. LLC

Q

Okay. Thanks. And so it sounds like you said that channel stabilized a little bit, but there has been some consolidation. So do you see any maybe risk of another step lower going forward as those wholesalers and some of your other customers kind of rationalize their businesses following those acquisitions?

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

A

I think we've seen some of that already, Greg, and there's always risk out there. What I would say is as people consolidate that sometimes that's a benefit as well because that stuff rolls into a platform that's got more power, more just market access and more capability. So it kind of depends. I can't see a big disruption at this point, but

I'm not claiming that won't happen, but I don't see anything like I said. I think it's pretty steady as she goes right now.

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

And just to add a little color, Greg, the wholesalers as a group are – they're a much smaller part of our business these days. It's less than 5% of our total consolidated sales. So the impact of any unforeseen event might be smaller now than it was two years ago.

Greg J. Burns

Analyst, Sidoti & Co. LLC

Q

Okay, thanks.

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

A

Thanks.

Operator: And your next question comes from the line of Budd Bugatch from Raymond James. Your line is open.

Alessandra Jimenez

Analyst, Raymond James & Associates, Inc.

Q

Good morning. This is Alessandra Jimenez on for Budd Bugatch. Thank you for taking my questions. I just wanted to quickly follow up on the softness in the contract business. What was order growth during the third quarter?

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

A

You got it.

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

Yes. Our third quarter contract business was up 12% versus prior year.

Alessandra Jimenez

Analyst, Raymond James & Associates, Inc.

Q

Okay. And then can you define the small- to midsized project size, like approximately what was that?

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

A

Yeah, that's a little bit in the eye of the beholder, but we kind of tend to look at that as about \$150,000 to \$400,000 net project size.

Alessandra Jimenez

Analyst, Raymond James & Associates, Inc.

Q

Okay. And then could you define the lead times you're experiencing now versus what they typically are?

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

A

There's been no significant change in lead times.

Alessandra Jimenez

Analyst, Raymond James & Associates, Inc.

Q

Okay. And then are there any new incremental investments in new products? And if so, what's kind of size of that investment?

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

No. We talk about this productivity net of investments. So we're on track to spend approximately \$15 million to \$20 million in investments this year. They're not different though. It's the same investments we've been talking about all year. And they're in a wide range of categories, including new products and other go-to-market initiatives. Digital and data analytics is a big category, as well as operational improvement.

Alessandra Jimenez

Analyst, Raymond James & Associates, Inc.

Q

Okay. And then do you have any gauge on 2020 on the incremental investments there?

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

We don't have a view yet of 2020. Clearly, we're going to need to keep investing in our business. We don't have a number for you at this point.

Alessandra Jimenez

Analyst, Raymond James & Associates, Inc.

Q

Okay. Thank you so much and good luck on the balance of the year.

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

A

Thank you.

Operator: Your next question comes from the line of Steven Ramsey from Thompson Research. Your line is open.

Steven Ramsey

Analyst, Thompson Research Group LLC

Q

Thank you for taking my questions. I guess to start, in supplies, how much of supplies is now e-commerce-driven? And I guess, kind of on what's been achieved to-date and where it's going, what is the e-commerce percentage of contract sales? And then, will the margin structure fundamentally get better as this shift plays out? Or is it already fundamentally better?

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

A

Yeah, a lot there. Let me kind of take them in order. First of all, e-commerce, it today represents about 5% of our total business. It has been growing nicely. And it's largely complementary to our existing core business. It primarily reaches the customer segment that we previously did not reach. Other questions?

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

Steven, it is primarily almost completely within the supplies numbers that we quote, so it's not in contract.

Steven Ramsey

Analyst, Thompson Research Group LLC

Q

Got you. Got you. And so on the supplies business solely, are margins better with this e-commerce channel?

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

The margins are similar. The business model's different, of course, and that's a rapid growth business that we're clearly investing in. But if you think about incremental margins, pretty similar to the other parts of the supplies business.

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

A

Yeah, and I think we're investing heavily right now in that business too. We're growing and we saw 30% growth rates in the first half of the year, and we continue to – it'll continue to contribute and those investments will lever even more as we go on.

Steven Ramsey

Analyst, Thompson Research Group LLC

Q

Excellent. And then on freight and distribution costs down slightly while sales up slightly, how much of that is just inflation and transportation was so much worse last year or is this a fundamental shift in the business?

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

I think we're making really good progress on our productivity initiatives. In the third quarter, a really large chunk of our productivity was in freight and distribution. So I think it reflects what we're trying to do and there is some inflationary there, but we're – inflationary pressures. We are able to offset that with the productivity and lower costs in general.

Steven Ramsey

Analyst, Thompson Research Group LLC

Q

And then kind of switching to hearth, I guess – I was surprised and maybe don't quite understand from the talk on the call thus far, how hearth was able to show improvement kind of prior to permits and starts picking up? Maybe just kind of talk to how your improvements lead what kind of the macro data is showing?

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

We were up 2.1% in new construction in the hearth during the quarter, and I include some price realization. So if you think about non-price growth, we were pretty similar to the permit data. So I'm not sure that we're really much different from the overall market. Now we have a lot of initiatives underway to add growth. And we did a nice job of managing our costs in the quarter, so we're able to expand profit in that business. But top line, I think, is tracking pretty much with the market at this point, maybe a little bit better because of our initiatives.

Steven Ramsey

Analyst, Thompson Research Group LLC

Q

Excellent. Okay. And then lastly for me, I guess on the international front, how much does international compose of contract sales? And I guess, I'm interested to know current demand, but would be more interested to learn kind of where you are in the long-term build out of the international business? And kind of where you see it going over the medium to long term?

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

A

Yeah, that's – today, that business represents about 7% of office furniture and 5% of the total portfolio. The platforms are growing nicely. We grew that business last year at a rate of 11%. It's growing at the same rate in the first half of this year at 11%, and we're seeing momentum accelerate in the back half. So we like those platforms both in PRC and in India. And investments continue to be made there. We have strong momentum. And we like the prospects of both those platforms to support both in market business and also our HNI global account business that works closely with those teams.

Steven Ramsey

Analyst, Thompson Research Group LLC

Q

Perfect. Thank you.

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

A

Thank you.

Operator: There are no further questions at this time. Mr. Lorenger, I turn the call back over to you for some closing remarks.

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

Well, thank you. We appreciate everyone's continued interest in HNI and for spending some time with us this morning. Have a great rest of your day. Thanks.

Operator: Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.

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