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HNI Corp. (HNI)

Q2 2019 Earnings Call

CORPORATE PARTICIPANTS

Jack D. Herring
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Marshall H. Bridges
Senior Vice President & Chief Financial Officer, HNI Corp.

Jeffrey Lorenger
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OTHER PARTICIPANTS

Budd Bugatch
Analyst, Raymond James & Associates, Inc.

Greg J. Burns
Analyst, Sidoti & Co. LLC

Matt McCall
Analyst, Seaport Global Securities LLC

Steven Ramsey
Analyst, Thompson Research Group LLC

MANAGEMENT DISCUSSION SECTION

Operator: Good morning. My name is Heidi, and I will be your conference operator today. I would like to welcome everyone to the HNI Corporation Second 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 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 second 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 am pleased to turn the call over to Mr. Jeff Lorenger.

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

Thanks, Jack. Good morning, everyone. We will share our assessment of the second quarter and provide some thoughts on our outlook for the rest of the year. We will then open up the call for questions.

Our teams continued to perform well in the second quarter. We are managing through some dynamic market conditions, staying focused on our key initiatives, and are on track to deliver profit improvement in the second half.

On our last earnings call, we indicated that delivering on our productivity targets would be a key driver for our results this year.

I am pleased to report that these efforts are on track and bearing fruit. We are also seeing activity ramp-up in our contract office furniture business with double-digit order growth in the second quarter. We have a strong position and are executing well in an active market. As a result, we are confident our contract business will generate strong second half growth and are raising our second half sales expectations for the contract business.

Our hearth business is performing well, while navigating a slower than anticipated housing market. As expected, hearth sales were down slightly from last year driven by lower single family housing starts. Despite the softer market, hearth continues to create significant shareholder value. We are confident about the long-term growth we can generate with our market leading positions and our initiatives to increase penetration.

Second quarter demand in our supplies-driven business was inconsistent and soft which negatively impacted our results. I would like to remind you that this business primarily targets small- to medium-sized businesses and is short cycle in nature. We believe macroeconomic concerns and general uncertainty continue to weigh on small business owners. That uncertainty, when combined with the short cycle nature of this market, has led to sharp swings in buying patterns.

Specifically, demand weakened in mid-April driving much of the quarterly shortfall. We did see demand improve in May and June. However given what we have seen so far this year, we are lowering our supplies driven revenue expectations for the year. Despite these near-term challenges, the small business market remains attractive and we feel good about where we are heading with our strategies to grow the business in the mid and long term.

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

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

Thanks, Jeff. Second quarter consolidated organic sales were down 2.3% versus the prior year. Including the impacts of closures and divestitures, sales were down 3.2%. In the office furniture segment, sales decreased 2.2% organically. Within office furniture, sales in our supplies-driven business decreased 5% and sales in our contract business were up 1% organically.

Hearth segment sales decreased 2.7%, with a similar decline in both new construction and retail products. Non-GAAP net income per diluted share was \$0.38 compared to \$0.44 in the second quarter of 2018. Compared to last year, non-GAAP EBIT was down \$4 million. Lower volume combined with increased input cost drove an estimated \$25 million headwind to our bottom line. We were able to offset most of that through cost management, lower BST cost and price realization. Jeff?

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

Thanks, Marshall. For the full year, we continue to expect to drive profit growth. We are focused on managing the business to deliver on our profit commitments, despite demand challenges in some of our markets. The primary driver of the second half profit improvement results from our productivity and cost savings efforts. We are on track with these initiatives and are confident they will deliver a net \$10 million to \$15 million profit improvement in the second half.

Additionally, relative to the first half, we do anticipate stronger second half demand driven by a couple of factors. First, we expect strong sales in our contract business. As I mentioned earlier, we are seeing strong order intake and strong activity in the contract space. As a result, we are projecting double-digit growth in the back half, which is a few points higher than what we previously expected for the contract business.

Second, we expect our supplies-driven business will be up low- to mid-single digits in the second half driven by e-commerce growth, price realization to offset higher tariffs and general stabilization of small business demand. Although we are projecting second half growth in supplies, it is a couple of points lower than what we previously expected. It is also more weighted to the fourth quarter when the prior-year comparables ease and e-commerce accelerates.

Finally in hearth, we expect modest growth. We are seeing retail demand improve while new home construction remains slower than last year. This led to low-single-digit second half growth, which is a few points lower than previously expected. I'm confident in our strategies and our ability to grow profit for the full year.

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

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

Great. I'm going to cover some of the details around our full-year outlook. Our full-year forecasted net income per diluted share has narrowed and is now in the range at \$2.50 to \$2.70. We now expect full-year consolidated organic sales to be up 1% to 4%, or flat to up 3% when including the impacts of closures and divestitures.

We're expecting sales in our supplies driven business will be down 2% to up 1%. In our contract office furniture business, we expect organic sales will be up 5% to 8%. When including the impacts of closures and divestitures, sales and contract are expected to be up 2% to 5%.

In hearth, we now expect sales will be flat to up 3%. As Jeff mentioned, we expect our sales and profit improvements will become progressively better as we move through the back half of the year, with fourth quarter results outpacing those in the third quarter. Jeff?

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

Thanks, Marshall. We have some short-term headwinds to navigate. That said, I remain confident about the opportunities in front of us to grow the business, expand profits, and drive increasing value for our shareholders. We are focused on strengthening our operational model and creating effortless experiences for our customers.

With those comments complete, I'll open it up for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. Your first question comes from the line of Budd Bugatch with Raymond James. Please go ahead.

Budd Bugatch

Analyst, Raymond James & Associates, Inc.

Q

Good morning. Thank you for taking the questions. You talk about the growth in contract being strong in the second half. Maybe you could give us a feel for what order growth was during the second quarter, because the overall contract I guess was up 1% and I guess with international up 0.9%?

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

A

Yes, Budd, good question. The second quarter orders were up double digits in the second quarter.

Budd Bugatch

Analyst, Raymond James & Associates, Inc.

Q

That's a large range, Jeff. Could you kind of maybe hone that in a bit?

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

They were in the low-teens, Budd, which is consistent with what we're expecting in the second half in terms of sales for contract.

Budd Bugatch

Analyst, Raymond James & Associates, Inc.

Q

So, backlog has got to be significantly higher year-over-year, right?

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

That's correct. It's been building through the first half.

Budd Bugatch

Analyst, Raymond James & Associates, Inc.

Q

And on a year-over-year basis or second-quarter versus first-quarter basis, however you want to look at it sequentially or year-over-year, how does that look?

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

Yes, it's up substantially, Budd, it's in the double digits.

Budd Bugatch

Analyst, Raymond James & Associates, Inc.

Q

Okay. And do you expect most of that to be delivered in third quarter or is scheduled deliveries throughout the second half?

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

It's throughout the second half. The third quarter for contract is expected to be stronger actually in terms of year-over-year growth.

Budd Bugatch

Analyst, Raymond James & Associates, Inc.

Q

Okay. That's helpful. And supplies, I'm kind of confused, what gives you the confidence that you can see some stabilization? And you talk about short-term headwinds to navigate, I'm still confused on to why supplies will stabilize and get better.

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

A

Yes, Budd. That's a good question. We have seen some stabilization. We really saw demand kind of stop, hit the brakes in late April, and started to recover in May and June. And we believe that recovery is a little volatile, that's why I say headwinds, but it has stabilized.

We have quite a bit of momentum in our e-commerce platform business, which also is in the supplies area. And candidly, the fourth quarter comparables eased quite a bit. Last year, quarters one through three, we were up 10% in the supplies channel. In the fourth quarter, we were only up 3.5%. So, that eases. And then, finally, we got more price-driven growth in the second half to offset tariffs. That's running about 2 points higher than the first half.

Budd Bugatch

Analyst, Raymond James & Associates, Inc.

Q

So, again, just trying to pinpoint you a little better, the third quarter, you still could see some issues in supplies, but that should markedly turn in the fourth quarter? Is that the way to think about it or is that too draconian?

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

Budd, I think the third quarter will still be improved, but because that lower comp we'll see better growth rates on a year-over-year basis in the fourth quarter. But we're expecting improvement in the third quarter on supplies.

Budd Bugatch

Analyst, Raymond James & Associates, Inc.

Q

And you expect supplies to be up in the third quarter year-over-year?

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

No, I'm not so sure of that. We'd probably be roughly flattish. For the back-half, our guidance implies low- to mid-single digits for the second half.

Budd Bugatch

Analyst, Raymond James & Associates, Inc.

Q

Okay. All right. And lastly for me on hearth, again, you talk about retail products improving the hearth outlook. But in the second quarter retail products were down similar to what construction was down. What gives you the comfort that retail will improve over the slowed construction issues?

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

A

Yes, Budd, it's a little similar to the contract furniture story. The activity levels are ramping up and we also had an inventory issue unwind in the second quarter. And had that been normalized, actually Q2 would have been up about 4% in the remodel space. So that also...

Budd Bugatch

Analyst, Raymond James & Associates, Inc.

Q

I am not sure I understand what that means. I don't know what unwinding is.

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

There's some inventory in the system that destocked – we've made some distribution changes and had the result of lowering our sales a bit, although there's still demand out there.

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

A

Yes, we had a wholesale relationship, Budd, that we took offline and went direct. And so, that stuff is – didn't repeat, but it's just selling through on more of a day-to-day basis.

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

And just to remind everyone that the retail channel is disproportionately weighted to the last four months of the year. So these small changes can make a big difference in the growth rates in the first and second quarter.

Budd Bugatch

Analyst, Raymond James & Associates, Inc.

Q

That's helpful. All right. Thank you very much. Good luck on the balance.

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

A

Thanks, Budd.

Operator: Your next question comes from the line of Matt McCall with Seaport Global Securities. Please go ahead.

Matt McCall

Analyst, Seaport Global Securities LLC

Q

Thank you. 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 maybe I'll start with the cost takeout. Remind me, maybe Marshall, the specifics around the cost takeout, what you're doing in the back half – forgive my memory but – and then more specifically the timing of that, I think Jeff you said \$10 million to \$15 million benefit, how does it layer in the back half.

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

Yes. Matt, we're expecting productivity net of investments to deliver \$10 million to \$15 million for the year. That's all going to hit in the back half. This is consistent with what we've been saying for the year. We're doing pretty well right now or maybe a little bit ahead of schedule. We feel like we're going to get that \$10 million to \$15 million. It's a little weighted to the fourth quarter, but there'll be some benefit in the third quarter as well.

Matt McCall

Analyst, Seaport Global Securities LLC

Q

Okay. So \$10 million to \$15 million – so do you expect that range there? I know that's the number you've been talking about but the range is still \$10 million to \$15 million. What makes it \$10 million, what makes it \$15 million?

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

This is a wide range of initiatives that really just has to do with how they progress and how much execution we deliver on those things. So I think we're probably more in the middle of that range. But there are things that are going to occur that cause us to go up or down from there.

Matt McCall

Analyst, Seaport Global Securities LLC

Q

Okay. You mentioned in the release and I think you just talked about again, Jeff, the effortless experience for the customer. Can you tell us more about what you're doing there? I assume there's maybe some investment that's involved in improving that experience, making it effortless, can you just tell us more?

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

A

Yes, Matt. We are really spending a lot of time on understanding our customers' journeys and in their purchasing process, and really spending time on meeting those customers where they want to be met in the process. And it's early on, but we've got a lot of investment behind that, and we're organizing ourselves around that. And then we're pushing forward tools in order to interact with our customers to make it a lot easier to interact with us.

Matt McCall

Analyst, Seaport Global Securities LLC

Q

So, Marshall, when you talk about \$10 million to \$15 million net of investments, does that net of investments, does that inclusive of any investment you are having to make around that effort?

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

Yes it is, Matt. It includes the digital and analytics investments as well as our go-to-market investments that Jeff is referencing.

Matt McCall

Analyst, Seaport Global Securities LLC

Q

Okay. So digital and go-to-market, okay. So, can you – I missed the outlook, I think you said hearth flat to up 3%. But what was new versus retail on the full-year outlook?

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

In the – for hearth?

Matt McCall

Analyst, Seaport Global Securities LLC

Q

Yes.

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

Yes. New construction for the full-year outlook is minus 2% to plus 1%, and we expect retail products in hearth to be up 3% to 5% for the full year.

Matt McCall

Analyst, Seaport Global Securities LLC

Q

And maybe on the new side, I understand the outlook, but just maybe the expectation I think broadly in housing with some improvement, I mean I know the comps for starts get a lot easier when you get in the back half and definitely into Q4. But maybe what are you hearing from some of your builder customers, what's the broader outlook just for housing in general?

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

A

Yes, Matt, I'd say early in the year, we had anticipated that the new home market would rebound more than it has – more than it looks like it's going to in the second half. I mean the permit data has not been as strong as some people thought it was going to be. So, we're kind of hearing what we're talking to you about for our business is that it's going to be – it's still going to be flat to down and maybe the rebound is going to be delayed a little bit longer than people had anticipated.

Matt McCall

Analyst, Seaport Global Securities LLC

Q

As you talk to those builders, Jeff, is that the view that there's still an anticipated rebound, but any thoughts on what's really delaying it? Anything interesting that you've heard?

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

Matt, I think we look at the housing permits and our new construction channel has a pretty decent relationship to that and it's still down. So, it's kind of supporting our view of a little bit more of continued softness and new construction in the back half.

Matt McCall

Analyst, Seaport Global Securities LLC

Q

Okay.

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

A

I think people overall have gotten a little more cautious, Matt, as we talk to them than they were three, four months ago.

Matt McCall

Analyst, Seaport Global Securities LLC

Q

Any more color on why that is, what are they talking about rates come back, rates have pulled back a little bit, I mean just curious if you hear anything different than the...

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

A

Not really. You probably hear what we hear, Matt.

Matt McCall

Analyst, Seaport Global Securities LLC

Q

Okay.

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

A

Not really.

Matt McCall

Analyst, Seaport Global Securities LLC

Q

Yes. That's fair. Okay. Thank you, guys.

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

A

Thanks.

Operator: Your next question comes from the line of Greg Burns with Sidoti & Company. Please go ahead.

Greg J. Burns

Analyst, Sidoti & Co. LLC

Q

Morning. The supplies business is – the weakness you're seeing completely macro related, or is there any market related changes maybe in terms of market share or impact from your wholesale consolidation with the acquisition of [ph] Ascendance (19:09). Is there anything else besides macro that might be affecting that business? Thanks.

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

A

Yes, Greg. Not that we can see at this point. Yes, there's always movement around the channels but we haven't been able to pick up any specifics there on that. I mean the data we have, when we talked about April for instance hitting the brakes, all our channel partners and all our customers almost to the person talked about a similar slowdown. So that's our best view at this point.

Greg J. Burns

Analyst, Sidoti & Co. LLC

Q

Okay. Thank you.

Operator: And your next question comes from the line of Steven Ramsey with Thompson Research Group. Please go ahead.

Steven Ramsey

Analyst, Thompson Research Group LLC

Q

Hi. Good morning. I guess talking about hearth penetration, increasing penetration, can you talk about what channel you're targeting? Is it builders, retail or dealers, or growing kind of the direct portion of the business? And does this type of sluggish environment make it tougher or easier to gain penetration?

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

That's a good question, Steven. So we're interested in all aspects of that market. It's not a terribly large market, and we have a reasonably large share there. But we have talked about, we've got ongoing initiatives to have better penetration of both the retail market, and we've talked about trying to promote and grow the category of fireplace inserts as well as replacing existing gas fireplaces as they age out.

We're also trying to work on trying to get better penetration in the lower price point homes which are a bigger mix of the starts these days by making sure we educate the homeowner about the benefits of putting a fireplace in when they build a home as opposed to trying to do it later.

Steven Ramsey

Analyst, Thompson Research Group LLC

Q

Great. And switching to logistics, you guys before kind of the freight pressures hit last year, how would you describe the logistics pressures now versus last year? And does the facility consolidation that you have conducted over the past few years, has that played out to be negative or positive as far as costs go?

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

As it relates to freight costs, we have seen year-over-year pressures but they have been less than we expected. So, we're pleased by that. But if you look at it from a high view, it's still a pretty competitive marketplace.

Steven Ramsey

Analyst, Thompson Research Group LLC

Q

Got you. That's it for me. Thanks.

Operator: And we have a follow-up from the line of Budd Bugatch with Raymond James. Please go ahead.

Budd Bugatch

Analyst, Raymond James & Associates, Inc.

Q

Yes. Marshall, I'm kind of looking at the slide on the second quarter results and you can see the improvement in F&D year-over-year, so we see that. But the non-GAAP SG&A excluding F&D pretty flat on significantly lower revenue. Can you kind of walk us through what's going on there, it's 50-basis point going the wrong way?

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

Yes. So, I'll answer the freight first. We are – we talked about having benefits of BST costs. Some of those hit freight last year as we were kind of inefficient as we went live. We're also seeing some better productivity there. So, as it relates to SG&A, we are seeing some inflation there, your typical wage inflation offset by cost management, so that's why it's basically flat. In fact, other than the freights is a benefit from the volume.

Budd Bugatch

Analyst, Raymond James & Associates, Inc.

Q

And this \$10 million to \$15 million of productivity in the back half, what's the geography of that on the P&L?

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

Oh, it's predominantly in cost of goods sold. There is some benefit that hits freight, but it's less than a quarter of it.

Budd Bugatch

Analyst, Raymond James & Associates, Inc.

Q

Okay. And how much of that is a flow-through after investments? I mean, you're going to invest and that's going to show up on SG&A. Where is that going to show up, maybe some your growth investments or the other things you – initiatives that you've got?

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

Yes, that's a good question. The investments are both in SG&A and cost of goods sold. They're – I'm not sure I have a precise number for you, Budd, but I'd roughly say they're roughly equal in those two categories.

Budd Bugatch

Analyst, Raymond James & Associates, Inc.

Q

And how much of those investments? So, what's the net flow-through, are they \$10 million to \$15 million?

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

The net investments would be in the \$15 million to \$20 million range and the productivity would be closer to the \$25 million to \$30 million, but it will net to be \$10 million to \$15 million in total.

Budd Bugatch

Analyst, Raymond James & Associates, Inc.

Q

So, the \$10 million to \$15 million productivity is net flow-through for the P&L?

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

Correct. Yes. Exactly. And we're seeing that ramp up and I feel confident in that number.

Budd Bugatch

Analyst, Raymond James & Associates, Inc.

Q

Okay. Thank you very much.

Marshall H. Bridges

Senior Vice President & Chief Financial Officer, HNI Corp.

A

Thank you.

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

A

Thanks.

Operator: And as there are no further questions in the queue, I'd like to turn the call back to Mr. Lorenger for closing comments.

Jeffrey Lorenger

President, Chief Executive Officer & Director, HNI Corp.

Thank you, everyone. As always, we appreciate your continued interest in HNI and for spending time with us this morning. Have a great day.

Operator: And this concludes today's conference call. You may now disconnect.

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