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Conduent, Inc. (CNDT)

Q1 2022 Earnings Call

CORPORATE PARTICIPANTS

Giles Goodburn

Stephen Wood

Vice President-Corporate FP&A and Investor Relations, Conduent, Inc.

Chief Financial Officer, Conduent, Inc.

Clifford A. Skelton

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OTHER PARTICIPANTS

Puneet Jain

Analyst, JPMorgan Securities LLC

Zack Ajzenman

Analyst, Cowen Inc.

MANAGEMENT DISCUSSION SECTION

Operator: Greetings and welcome to the Conduent First Quarter 2022 Earnings Announcement. At this time, all participants are in a listen-only mode. A brief question-and-answer session will follow the formal presentation. [Operator Instructions] As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Giles Goodburn, Vice President of Investor Relations. Thank you, Giles. You may begin.

Giles Goodburn

Vice President-Corporate FP&A and Investor Relations, Conduent, Inc.

Thank you, operator, and thanks, everyone, for joining us today to discuss Conduent's first quarter 2022 earnings. We hope you had a chance to review our press release issued earlier this afternoon.

Joining me today is Cliff Skelton, our President and CEO; and Steve Wood, our CFO. Today's agenda is as follows. Cliff will provide an overview of our results and a business update. Steve will then walk you through the financials for the quarter as well as providing a financial outlook. After that we will take your questions.

This call is being webcast. A copy of the slides used during this call as well as the press release were filed with the SEC this afternoon on Form 8-K. This information as well as the detailed financial metrics package are available on the Investor Relations section of the Conduent website.

During this call, we may make statements that are forward-looking. These forward-looking statements reflect management's current beliefs, assumptions and expectations, and are subject to a number of factors that may cause actual results to differ materially from those statements. Information concerning these factors is included in Conduent's Annual Report on Form 10-K filed with the SEC. We do not intend to update these forward-looking statements as a result of new information or future events or developments, except as required by law.

The information presented today includes non-GAAP financial measures. Because these measures are not calculated in accordance with the US GAAP, they should be viewed in addition to and not as a substitute for the company's reported results. For more information regarding definitions of our non-GAAP measures and how we use them as well as the limitations to their usefulness for comparative purposes, please see our press release.

And now, I'd like to turn the call over to Cliff.

Clifford A. Skelton

President, Chief Executive Officer & Director, Conduent, Inc.

Thanks, Giles. Good afternoon, everyone, and welcome to Conduent's Q1 earnings review. We appreciate everyone joining us today.

Turning to slide 4, you're going to hear several important things from us today, starting with the fact that we had a solid quarter. Steve Wood is going to take you through the details, but we earned \$960 million in revenue, \$107 million in EBITDA, and achieved an 11.1% EBITDA margin. Importantly, it was one of the best, in fact, the best first quarter since spin, with total contract value sales at \$464 million, up 32% year-over-year and 58% sequentially. We also had improvement in annual contract value, which we'll see when we get into the details in a minute.

You can see on slide 5 that we also received a lot of recognition, including but not limited to GM Supplier of the Year for the second year in a row and other great accolades from advisory firms and other industry analysts. This recognition demonstrates the significant improvement we made across all three of our business segments and the company in general.

After Steve's detailed presentation on the financials, I'm going to take you through the fine points of what you may have read in one of our press releases that we have decided to separate our Transportation business. Our expectation at this point is that we will focus on spin versus sale.

I'm going to talk about the rationale for this decision. We're approaching this effort through a very disciplined set of routines around both Transportation and the other two remaining segments of Conduent in what will become two public companies. We're excited about what we think will be a great outcome for both entities.

So, with that, let me turn it over to Steve and let him take you through the details of the financial and sales results for the quarter, reaffirm our full year outlook for 2022, and then I'll come back and talk more about Transportation and the separation. Of course, we'll take questions at the end.

So, Steve, why don't you take it from here?

Stephen Wood

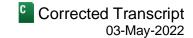
Chief Financial Officer, Conduent, Inc.

Thanks, Cliff. As we have done in the past, we are reporting both GAAP and non-GAAP numbers. I would like to point out that certain non-GAAP measures adjust for the Midas divestiture. This is similar to past practice. The reconciliations are in our filings and in the appendix of the presentation.

Let's turn to slide 6 and discuss our key sales metrics. As Cliff mentioned, we had our strongest first quarter for overall TCV sales attainment, a 32% increase over Q1 2021. It was also up sequentially 58% versus Q4 2021.



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Both our Transportation and Commercial segments were up strongly both year-over-year and sequentially. Our Government segment was slightly lower, but its pipeline of late-stage deals remains strong. New business ARR was also up 14% over Q1 2021.

In 2022, we launched and enhanced integrated sales model to optimize the balance between near-term and long-term revenue needs and changed our sales compensation models to further incentivize these outcomes with the primary focus on annual contract value. As a reminder, we define ACV as total contract value, or TCV, divided by term.

While our ACV reduced 20% as compared to 2021, this impact was driven by the onetime government stimulus volumes in Q1 2021 as well as another onetime volume item for a large client that we no longer record in our sales metrics. Removing these presents a more apples-to-apples view of our ACV. Under this view, ACV grew 12% as compared to Q1 2021.

The sales metric trend on the following slide has the same breakout, so you can see the upcoming effect in Q2. The net ARR activity metric, our combined measure of wins, losses, pricing effects, and other contractual changes was positive for the sixth quarter. As a reminder, this trailing 12-month measure does not predict the timing of revenue, but is based on the timing of notification and as such will fluctuate from quarter-to-quarter. A full definition of this metric is covered in the appendix of our presentation.

Turning to slide 7, our trends on new business ACV and ARR are encouraging, and our NRR has returned to more normalized levels, now we have runoff the effect of government stimulus. Our average contract length in the quarter was 3.8 years, which is somewhere near our long-term average. We had another busy first quarter renewing \$936 million of TCV with several large clients renewing their agreements and demonstrating their satisfaction and a strong commitment to Conduent as their business process partner. As we have noted before in prior calls, individual quarters can have significant variation due to timing of renewals.

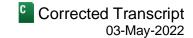
Now, let's turn to slide 8 and discuss our Q1 2022 financial results. Adjusted revenue for Q1 2022 was \$960 million as compared to \$1.01 billion in Q1 2021, down 5% year-over-year and slightly ahead of our internal expectations for the quarter. The year-over-year headwind from the roll-off of government stimulus in the quarter was \$27 million. Removing that, the reduction would have been 2.3% year-over-year. Adjusted EBITDA was \$107 million for the quarter, up slightly as compared to \$105 million in Q1 2021, and the adjusted EBITDA margin of 11.1% was up 70 basis points year-over-year as compared to Q1 2021.

Q1 2022 contained a onetime item related to the recovery of approximately \$14 million of defense costs as a portion of the settlement with our insurance carriers related to a previously disclosed legal matter. Removing this item, which was not part of how we guided the adjusted EBITDA and margin for the quarter, would have resulted in a 9.7% margin, slightly better than how we guided in our recent 2021 full year earnings call.

Let's now turn to slide 9 and go over the segment results. For Q1 2022, Commercial segment adjusted revenues were flat year-over-year at \$512 million as ramp from new business wins begins to more than offset losses from prior years. This is the first quarter that the Commercial segment has not declined year-over-year since spin and we're pleased with the progress that has been made, while acknowledging there is always more to do, as we return the Commercial segment to a sustained path of revenue growth and margin expansion.

We anticipate the impact of a long-planned merger-related revenue reduction from an existing client in Q2 will result in us showing a small year-over-year revenue decline. However, we remain confident on the full year outcome, which I'll talk more about in a minute as we reflect further on full year guidance. Adjusted EBITDA for

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the Commercial segment in Q1 2022 was \$54 million, up 5.9% as compared to Q1 2021, and the adjusted EBITDA margin of 10.5% was up 50 basis points year-over-year driven by operational efficiency initiatives across the segment.

For the Government segment, Q1 2022 revenues were \$286 million, down 8.9% compared to Q1 2021. The year-over-year impact of the runoff of government stimulus was \$27 million in the quarter. Removing that impact, the underlying base business would have been substantially unchanged year-over-year. Adjusted EBITDA for the Government segment in Q1 2022 was \$83 million, down 7.8% year-over-year, reflecting the runoff of government stimulus volumes, partially offset with operational efficiency initiatives. The adjusted EBITDA margin of 29% was up 30 basis points year-over-year.

Transportation segment revenues in Q1 2022 were \$162 million, down 12% year-over-year. We did expect the Transportation segment to be down in the first quarter, a function of the timing of our strong new business ramp, the majority of which comes on in late-Q2, early-Q3 timeframe, coupled with prior-year losses and a onetime revenue item that benefited the prior year. In addition to these items, which were well understood, timing in certain projects in some of our international businesses moved revenue into later quarters in 2022. We do expect these to catch up within the current year. Our full year revenue outlook for Transportation remains unchanged. For the Transportation segment, adjusted EBITDA for the quarter was \$17 million, down 43% as compared to Q1 2021, and the adjusted EBITDA margin was 10.5%, down 580 basis points year-over-year.

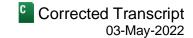
The Q1 2021 adjusted EBITDA margin of 16.3% was the high point in 2021, benefiting as it did from a onetime revenue item with a high fall through percentage to EBITDA that drove approximately 300 basis points of margin difference with the prior-year compare. We anticipate Transportation margins recovering in later quarters in line with the previous comments on revenue. We don't guide to adjusted EBITDA margin at the segment level, however, in the Transportation segment, our expectation is for full year margins to be at or slightly better than prior year on a full year basis.

Let's turn to slide 10 and discuss the balance sheet and cash flow. Our cash position remains healthy and we have a strong liquidity position. We ended the quarter with \$593 million of cash on the balance sheet. During the quarter, we closed the sale of our Midas Suite of Solutions, resulting in \$321 million of cash consideration, subject to customary working capital adjustments which we expect to finalize in Q2 and do not expect to be material. Overall cash flow was as expected this quarter with higher CapEx as a percentage of revenue reflecting timing of certain payments which will normalize over the course of the year.

On February 11th this year, we repaid the \$100 million of debt drawn under our revolving credit facility and our net leverage ratio decreased to 1.5 turns, which is below what we expect to be our normal range of 2 to 2.5 turns. As Cliff noted in his prepared remarks, we are indexing towards spinning the Transportation segment as a separate public company. As those plans develop, we will clearly provide additional color on how we think about our debt with respect to the two entities, their leverage and overall capital structure. In the short-term, we believe, it is prudent to retain flexibility with cash on hand as we work through those plans.

Let's turn to slide 11 and review our 2022 guidance. We are reconfirming all components of our full year 2022 guidance at this point. We expect adjusted revenues in 2022 to be in the range of \$3.825 billion to \$3.975 billion. As a reminder, this excludes the impact of the disposition of the Midas business. We have no material changes to our view of the annual segment level growth trajectories we called out in our full year 2021 earnings update. Our view is that all three businesses are on track to meet their full year commitments. With a strong start to our sales year, this should feed into our revenue ramp in the second half of the year.

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However, we do expect overall adjusted revenue in Q2 to be sequentially lower than Q1, specifically in the range of \$925 million to \$935 million. In Q2 2022, the year-over-year impact of the roll-off of government stimulus is approximately \$65 million. There is also an annual component of this sequential trend Q1 to Q2, which relates to the yearly cycle of open enrollment for our healthcare clients, which starts in Q4 and ends in Q1 the following year. Additionally, the earlier items that I mentioned with the roll-off of revenue in the Commercial segment related to a long-planned merger-related activity from an existing client also plays into that rubric.

We expect adjusted EBITDA margins to play out similarly to how we talked about them in our recent 2021 full year earnings call, starting the year at or slightly below the guided range and finishing the year at or slightly above the guided range. We still expect to convert approximately 15% of adjusted EBITDA to adjusted free cash flow, inclusive of paying off the remaining portion of the deferred payroll taxes under the CARES Act. Similarly, we are not changing our outlook on CapEx or restructuring charges.

That concludes our financial review for Q1 2022 and I'll hand it back to Cliff to talk further about the Transportation announcement. Cliff?

Clifford A. Skelton

President, Chief Executive Officer & Director, Conduent, Inc.

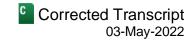
Thanks, Steve. So, as you can imagine, we're really proud of the progress we've made with client recognition, industry recognition, revenue, EBITDA, margin and sales. As I mentioned, of significant importance is the announcement we made for the Transportation segment, where we said in previous press releases that we were going to separate the business and consider either a spin or a sale. This is covered in our earnings press release where we're indexing primarily on spinning Transportation to create two public entities as opposed to a sale at this point in time. We looked closely at the analysis of spin versus sale, including the tax advantages of a spin. Our conclusion was that it didn't make sense to kick off an official process to sell with bankers and all the anticipation that goes with it.

As a reminder, this is a great business. It has scarcity value. It has unique software and technology value. It has fantastic clients that we've dedicated the last few years to retain and grow. It has the ability and opportunity to team with others and integrate payments and other opportunistically valuable technology. Again, we like this business and simply decided to take advantage of this growth opportunity on behalf of our own shareholders in the most tax efficient manner possible.

While other opportunities may surface and could be entertained, we're focusing our efforts on spin and to set ourselves up to grow two very different public entities. The spin will create two industry-leading focused companies. The Transportation business will become a pure-play industry leader, a company with truly multimodal assets and the only Transportation business in the market that can play into all areas of global transit, tolling, parking, and public safety. It will have extensive international scale and experience team, market-leading technology assets, and highly favorable industry dynamics that address smart cities and the monetization of urban mobility.

Conduent Commercial and Government will then itself become a more focused company, serving a phenomenal set of commercial, healthcare, and government clients with a range of solutions to address their business process and payment needs. It will be lean with solid margins, good cash conversion rates, and lower capital intensity. Now that the Commercial segment is trending toward growth, when combined with our leading position in state and local government's service and technology solutions, we see an outcome that should be uniquely positive for both the spun transportation business and the remaining Conduent business.

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We're going to create the right models for both companies with lots of new opportunities around things like payments, customer experience as a service, claims and other areas that we previously talked about. Now, there's a lot of work to get done here and we're very early in the process. We're now going to focus on how we divide up our corporate functions, how we stand up leadership teams, how we create a board of directors for the Transportation business, and how we do all of these efficiently and effectively. And you can be assured that we'll approach this in a very detailed person by person, product by product approach, so that you can have confidence in the outcome likely a year or so from now.

We'll have quarterly routines to report our progress along the way to our investors and certainly to the board on a monthly basis. Many of the folks that will be working on this project have done this kind of separation or integration work before in several Fortune 500 companies and you should expect us to be very rigorous and disciplined about it. So, as you can tell, we're very positive about this. There's a lot of work to go do, and as I've said, we have the right team to go do just that work. As always, I'd like to thank our clients, our associates, and our shareholders for their continued support. Conduent is in a good spot and we are motivated.

Thank you all for joining us today. Now, we'll open up the lines for some questions. Operator?

QUESTION AND ANSWER SECTION

Operator: Thank you. We will now be conducting a question-and-answer session. [Operator Instructions] Thank you. Our first question comes from Puneet Jain with JPMorgan. Please proceed with your question.

Puneet Jain

Analyst, JPMorgan Securities LLC

Yeah. Hey. Thanks for taking my question. The Transportation revenue in this quarter came in below our expectations, but you – I think, Steve, you said that you expect some of that delayed work to come back in later quarter this year. So, how much confidence you have, like what visibility you have in some of that work coming back and the trend rates improving in that business? And your guidance also, the full year guidance, given what you expect for Q2 implies significant ramp up on a sequential basis in 3Q and 4Q. So, is that also like that sequential ramp that you expect in second half of this year, does that also depend on Transportation volume coming back in second half?

Stephen Wood

Chief Financial Officer, Conduent, Inc.

Yeah. Puneet, thanks for that. So, look, yeah, the Q1 – thinking about Q1, first of all, I mean most of the effects that took place in Q1 were well understood, the prior-year losses, the onetime that existed in the prior year that gave the compare an element of challenge and also some FX drag in it. The project component of it is something that we do expect to come back, some of it will come back in the second quarter, some of it will come back in the latter quarters of the year, but yes, we do expect that to catch up.

Thinking about Q2, and you mentioned the sort of step up in the revenue on a sequential basis, on a constant currency basis, my expectation for Q2 is that we'll be somewhere close to flat year-over-year on the top line, because some of that ramp, some of those projects are coming back and some of that ramp is starting to take place. One thing to remember about the Transportation business is it had a really, really good sales year last year, and in the latter part of 2020 with three large tolling contracts that are starting to build into our run right now as we get into the second half of the year.

So, what you're going to see sequentially as we go through the year with Transportation is the effect of that ramp building in Q2 and in Q3 again, and then, obviously, we've got the effect of a good strong sales quarter this quarter also sort of feeding into it. So, right now, our overall view, going back to my prepared remarks, is that on a full year basis, I'm not seeing any reason for us to change our view of the segment level full year revenue outcomes. We remain confident on the business on a full year basis.

Clifford A. Skelton

President, Chief Executive Officer & Director, Conduent, Inc.

Yeah. Puneet, as Steve said, we expected the lumpiness that we're seeing. The timing could have gone either way between Q1 and Q2, and you're always going to see a little bit of that primarily in the international transit business. It's a little more consistent and leveled out in the tolling business, but that is part of the course in transit. So, it's going to recover.

Puneet Jain

Analyst, JPMorgan Securities LLC

Understood. And then, in Transportation business, with this upcoming spinoff, how should we think about potential dis-synergies from those actions, not just in terms of customer accounts, but also in terms of internal capabilities, like if there were any cross-selling of capabilities of one business unit into others, and if you can also talk about potential impact of spinoff, does that create near-term distractions in your Transportation business?

Clifford A. Skelton

President, Chief Executive Officer & Director, Conduent, Inc.

Sure. It's a great question. We're early in the process. We see very few dis-synergies, if you will. It's a standalone business. There are really no cross-functional clients across segments from Transportation. There's some infrastructure that we'll need to segregate. There's a lot of project work they will need to take place to stand up a new public company, and make sure we look at the corporate functions and decide how we divide those up. We'll have – we've already established a project team to go do that work to look at the as-is and the to-be in the environment, but we see very, very few dis-synergies, we see only upside to this opportunity.

Steve, any comments on that?

Stephen Wood

Chief Financial Officer, Conduent, Inc.

No. I would echo that. I think internally the business is quite well segmented already and beyond the fact that there are, obviously, certain costs that go with running a public company.

Clifford A. Skelton

President, Chief Executive Officer & Director, Conduent, Inc.

Yeah. And just to pile on a little bit, Puneet, obviously, in the press release where we said we're going to separate, there was frankly almost complete positive response from our client base. And so, they see this enhanced management focus. They see more tailored operating model. They see easier peer compares. They see focus capital management as all positives for this. So, from a client perspective and a growth opportunity, it's all upside for us. We just got to go do the work.

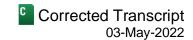
Conduent, Inc. (CNDT) Corrected Transcript Q1 2022 Earnings Call 03-May-2022 **Puneet Jain** Analyst, JPMorgan Securities LLC Got it. Thank you. Clifford A. Skelton President, Chief Executive Officer & Director, Conduent, Inc. Sure. Operator: Thank you. Our next question is from Bryan Bergin with Cowen. Please proceed with your question. Zack Ajzenman Analyst, Cowen Inc. Hi. Thanks. This is Zack Ajzenman on for Bryan. The question... Clifford A. Skelton President, Chief Executive Officer & Director, Conduent, Inc. Hey, Zack. Zack Aizenman Analyst, Cowen Inc. Hey. Just wanted to dig in a bit more on Transportation, perhaps bigger picture, maybe can you talk about the sustainable growth outlook for the business, understanding there's some lumpiness, but perhaps rolling it up across each of the underlying pieces could give us maybe a better feel of a sustainable growth outlook there. Also looking to kind of get a sustainable base build, so perhaps you can remind us on any ongoing legacy loss winddowns within the business? Clifford A. Skelton President, Chief Executive Officer & Director, Conduent, Inc. Yeah. So, look, we think on a standalone basis, there's a lot of opportunity. We looked very closely, as you might imagine, in spin versus sale. We looked at public company compares, we looked at growth rates both in a blue sky and a gray sky, we looked at potential partnerships, we looked at the fact that we haven't integrated things like payments which were clearly very close to being able to do, we looked at the tax implications, obviously, of spin versus sale, and then, we looked at - like I said, we looked at the current envisioned growth rates of lowsingle-digits today without any of those tack-ons or potential tuck-ins or potential partnerships that I just alluded to, low-single-digits with low-teens on margins and we see upside to both of those. But that's kind of where we see the base business right now in the Transportation space with significant upside to that as we execute on the strategy that I just described. So, not sure if that answered your question. So, again, repeating low-single-digit growth rates is what we see the base business doing, low-teens on margin, both with upside enhancement opportunity in the first three years of the spin.

That's helpful. And on some deal slippage that was called out last year...

Zack Ajzenman

Analyst, Cowen Inc.

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Clifford A. Skelton

President, Chief Executive Officer & Director, Conduent, Inc.

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Oh, yeah.

Zack Ajzenman

Analyst, Cowen Inc.

...and perhaps on bookings, too. Any update on the status of the deals that were pushed out into 4Q? We've seen, obviously, some announcements in recent months, but it sounds like perhaps there is some other pushouts, perhaps in transport that are expected to be more back-ended. Curious if COVID is still an overhang as it

relates to the pace of client decision-making and anything more broadly on kind of the characterization of the

client willingness here to sign deals?

Clifford A. Skelton

President, Chief Executive Officer & Director, Conduent, Inc.

Yeah. In the second half of your transport question, I didn't get to, which was really client attrition. And frankly, a lot of what we were worried about just two years ago has all been cleaned up in terms of client attrition. There's one large state client that has not finished making their decisions, but by and large, we know where the puck is going on attrition and we've renewed all that we had hoped to renew. And so, we've a lot of increased confidence in terms of client retention in the Transportation business.

With respect to deals that slid into Q1, most of those deals were associated with Commercial business. Now, there's – there was one in the Transportation business as well. And so, we have high confidence that it's still timing across Q1 – Q4 to Q1 and Q4 – even in Q2. And so, I would say 15% to 20% of the great sales quarter we had in Q1 was some of those that slowed from Q4 to Q1. But even notwithstanding that, we had a really solid quarter in Q1 in sales and we expect to have a pretty good Q2. So, [indiscernible] (00:32:39) Steve?

Stephen Wood

Chief Financial Officer, Conduent, Inc.

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Yeah. The only thing – I'd just reiterate what Cliff said there around sales and, yeah, we talked about the fact that there were some deals that got pushed from Q4 to Q1, but we baked that into our expectations in Q1 and we exceeded those expectations.

Clifford A. Skelton

President, Chief Executive Officer & Director, Conduent, Inc.

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Correct.

Stephen Wood

Chief Financial Officer, Conduent, Inc.

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So, we're off to a good start in terms of our sales here.

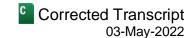
Clifford A. Skelton

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President, Chief Executive Officer & Director, Conduent, Inc.

But that would not be dominated by Transportation, Zack, just to be clear. Some of those – most of those are in the Commercial space.

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Zack Ajzenman Analyst, Cowen Inc.	C
Understood. Thanks very much.	
Clifford A. Skelton President, Chief Executive Officer & Director, Conduent, Inc.	A
You bet.	
Stephen Wood Chief Financial Officer, Conduent, Inc.	A
Thanks Zach	

Operator: Thank you. There are no further questions. At this time, I'd like to turn the floor back over to Clifford Skelton for any closing comments.

Clifford A. Skelton

President, Chief Executive Officer & Director, Conduent, Inc.

Thank you, operator. I appreciate everybody joining. As you can see, it's – we think a really good quarter, we think the announcement and clarity around spinning is really important to our clients and to our team. That clarity and focus for our bandwidth in the project is really important to us. And I think you should have confidence as investors that we're going to get this right for the remainder of the year. So, thank you all for joining and I appreciate your time today, and I hope everybody has a great remainder of the day today. Thanks.

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

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