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Freshworks, Inc. (FRSH)

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CORPORATE PARTICIPANTS

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Chief Financial Officer, Freshworks, Inc.

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Brian Schwartz

Analyst, Oppenheimer & Co., Inc.

MANAGEMENT DISCUSSION SECTION

Brian Schwartz

Analyst, Oppenheimer & Co., Inc.

Welcome. I want to thank everyone for dialing and get to hear a great story. We've got Freshworks presenting here today the company. With us is the CFO, Finance Leader, Tyler Sloat. And Tyler, hello. We appreciate your time here at...

Tyler Renwick Sloat

Chief Financial Officer, Freshworks, Inc.

You bet.

Brian Schwartz

Analyst, Oppenheimer & Co., Inc.

...the Oppenheimer Tech Conference.

Tyler Renwick Sloat

Chief Financial Officer, Freshworks, Inc.

Brian, thanks for having us. We're excited.

QUESTION AND ANSWER SECTION

Brian Schwartz

Analyst, Oppenheimer & Co., Inc.

Q

Well, let's just start with a little overview and the business trends. I'm going to assume that most of the folks tuning in are at least somewhat familiar with the business and the problems that Freshworks are solving. But maybe you can do a quick overview anyways Tyler. And then, could you give a quick recap of maybe the recent business trends, what you saw in Q2, what were the highlights in your view?

Tyler Renwick Sloat

Chief Financial Officer, Freshworks, Inc.

A

Yeah, absolutely. So Freshworks, we're a software company focused on helping our customers delight their customers and their employees. We have three main product lines, Freshdesk which is our biggest and oldest product, really providing customer support software for our customers to engage with their customers. Second is Freshservice, which is ITSM software. And then third is our CRM software really focus on fresh – fresh marketing (sic) [Freshmarketer] (01:22) first and now with Freshchat fully integrated in with those.

We're a little bit different and that we are truly a global company founded out of India, over 10 years old, went public last September, but really looking at the entire global market. And as such, we have a little bit more dispersion than in terms of our customer base in a traditional kind of Bay Area SaaS company that will grow – that start in North America and moved to Europe. We've kind of always been global with. About 40% of our business in North America, about 40% in the EU and about 20% in rest of world.

We also service kind of the SMB all the way up to that low enterprise customer. Freshdesk plays along all of those channels. Our biggest customers tend to be Freshdesk customers, but also playing fully into that SMB. We have three go-to-market motions. This is high velocity inbound motion, which is really organic paid search driven where customers land, they start a trial and that trial converts. That inbound motion service is a 100% of our SMB business, which is stratified these 250 employees and below. We have a mid-market enterprise motion, which is outbound, and that's really for reps that are in the field, but they tend to be inside reps still, but selling NGO, mainly in North America and Europe with some presence in South Asia as well.

Mid-market for us is 250 to 5,000 and enterprise is greater than 5,000. Our Freshservice product does have SMB customers, that mainly plays in the mid-market and enterprise. And we also have a partner channel, which we're utilizing to primarily engage with customers that we don't – NGOs that we don't have physical presence. That partner – those partners also do implementations and they also build applications that extend our software.

As I mentioned, three main product lines. The highlights for the quarter, I think we've performed really well in the quarter. We had highlighted some things in Q1, specifically some execution issues we thought we had in Europe, mainly around bigger deals. We saw some of those execution issues in Q2 with higher conversion rates and that we've seen in a while.

Our Freshservice product is doing really, really well. It's playing in a part of the market that just I think is underserved because you have ServiceNow on the high end, you've got some low-end players, and you have a bunch of legacy. And we are bringing a product to market that's truly providing value for our customers, can get it up and running really quickly and as with a great user experience, which is the hallmark of all of our products, right?

Really easy to use software, providing you all the functionality you need at a great value that you can be up and running really quickly. That up and running really quickly part is one of the reasons that professional services is actually not a big line item for us. Most of our customers can get kind of live in weeks and months and back services is not even really big enough to break out when we talk about revenue because it's relatively immaterial. And we want to relatively keep it that way too, because that is the way the software is built.

So that's the summary. We kind of – we do all this while we've been running in a really tradition – a historically efficient business. Last year we actually produced free cash flow. This year we said we're going to burn about – we started the year, we said we're going to burn \$25 million and we reduced that to \$20 million and we reiterated that the plan is to keep that at \$20 million and actually be kind of cash flow neutral positive from Q4 on. And we have \$1.2 billion in the bank and with no debt, and we feel like we're financially really healthy.

We talked about the back half of the year. We obviously gave our numbers. We did say that we are seeing some pressure on SMB globally and specifically at the low end of SMB. And that pressure is even magnified a bit in Europe. FX is a challenge for us because I talked about that base of European customer. We know we have about 40% of our business in the EU, not all of that is built in euro-pound, but we do have a decent amount of exposure in euro-pound and that has been a headwind, so we provide a lot of constant currency numbers in this last call. And then we said that Europe macro pressure, we're seeing it in general and we've taken all of that into account when we provided our numbers for the rest of the year.

So that's a summary, Brian. Hopefully, that's helpful.

Brian Schwartz

Analyst, Oppenheimer & Co., Inc.



It's a great summary and it's pretty consistent with what we're hearing from other companies in terms of our activity in SMB market in Europe, so on that. One question, maybe just to follow up on that, do you see companies at all like in this environment thinking about rationalizing their digital transformation roadmaps even at a faster pace now trying to reduce the number of vendors and suppliers at all? Do you see that?

Tyler Renwick Sloat

Chief Financial Officer, Freshworks, Inc.



Yeah. Yeah, we do. We provided a couple of anecdotes. We think there will be pressures on every company in selling software and whatnot as companies tighten their belts. I do think pressure will come also on the expansion motion and it just makes sense, right? If companies are laying off people or they're not hiring folks, then you would tend to not have expansion.

That being said, the way we bring our software to market and our value proposition is one that could – actually could benefit us in the markets that are tough because we can provide a great software at a great value. And even during COVID, we saw migrations off of more expensive solutions onto us. The second thing you talked about is consolidation across systems.

We did get one anecdote. I think it's in a callback around our new kind of our DC e-commerce solution, which is providing a marketing to sales, to customer support over chat experience for our customers to engage with their customers. And we do have customers who are now adopting that, raising value in this unified kind of experience of being able to replace a whole bunch of solutions with one, which would be ours. And so, we would expect that to continue. And obviously, you have to go and improve it for the customers. But once you can do that and then you have the references, then it starts to – tends to build on its own.

Brian Schwartz

Analyst, Oppenheimer & Co., Inc.



Great. One last question, just kind of the environment. There's always this debate here I had between front office and back office priorities in the slowing IT spend environment. You have a unique perspective, two ways, Tyler. One, you're a CFO. So what you're doing internally and your own investment decisions and approval processes? But then also the business, Freshworks is unique that you sell front office solutions and then you also sell back office solutions. Do you have a – maybe you share what you're doing internally. And then, do you have a perspective on maybe how SMB customers are prioritizing front office versus back office in the slowing IT spending environment?

Tyler Renwick Sloat

Chief Financial Officer, Freshworks, Inc.



Yeah. I think SMB in particular is going to always think more about front office, right? The back office, they can solve with a lot of manual, but there's not a lot there. What we do see in general, and this is the way we try to run it internally. So we do use our own software internally. And kind of the statement is, how do we make work easier, right? How do we make work easier for our go-to-market facing functions? How do we make work easier for our normal – just other functional employees? And that comes through, how do you get your normal – your administrative tasks done quicker? How do you get answers to your questions quicker with less clicks, with less kind of intervention with human? And that, we think, is just going to continue to drive.

So one is around conversational messaging, right, being able to quickly get answers to what you want. Second is around kind of AI and automation and being able to build in bots that can really remediate questions as fast as possible, and then that should get smarter over time. And that is the way we think all of the future is going. Well, on the conversational messaging, we think that's the future of support. We – our uptick, we have – we are multiproduct sale – our customers are multiproduct, has consistently kind of just ticked up slowly, but it really is driven by omni-channel, which is our desk solution and then adding capabilities around on chat. That is kind of what we've seen.

And then it's given us the thesis that we – the world is really moving to a place of more conversational messaging and quick answers and engagement on a more personalized basis. And when you can do that and inject it with kind of AI/ML capabilities, then you can provide a really great experience for your customer base with a lot of rapid answers without human intervention. And that's what we're trying to do, right?

We're trying to make it easy for our customers to be able to engage with our customers on an easier basis quicker, faster, smarter. Also engage with their employees to help their employees do their jobs better.

Brian Schwartz

Analyst, Oppenheimer & Co., Inc.



Okay. Let's talk a little bit about the moat and the competitive differentiation. You're in two different markets here with the customer in the IT markets. Clearly, those are well-established. They're crowded software market. So, what is the differentiation? Who do you end up displacing? Does it vary by category or geography? And then share with us the differentiation why you win in the market?

Tyler Renwick Sloat

Chief Financial Officer, Freshworks, Inc.



It does vary, some geographical variant, but also by, obviously, our product lines. If you think about our desk solution, right, we've always competed with kind of Salesforce and Zendesk, and then that product has a feature

functionality that we can go engage with large enterprises. It's just not ourselves much, and we're not trying to go after those big deals. We want to be brought into those big deals.

But as I mentioned earlier, our largest customers are the ones who are paying us over \$1 million a year. Those tend to be desk customers, most likely BDC businesses that have high agent counts. The differentiation has been around that omni-channel capability when we're engaging with those larger companies that are out there that we brought that out first or before them and then we think that we can provide a better omni-channel experience and then are moving fast to conversational messaging.

You definitely have point solutions in that space as well that customers are looking straight to those point solutions. So we see those as competitors as well. And then the – on the SMB side, there's a litany of competitors across the board, and we don't always know who they are. So our job is to great – to provide a great trial experience, really showcase the technology as fast as possible during trial to have some type of engagement with potential customer and get them closed.

On our Freshservice product, that is kind of – we're saying is, like, hey, it is right-sized for you. We can get you up and running really quickly with all of the feature function that you need. We're not trying to have every bell and whistle in the house and we're not really trying to compete with ServiceNow there. If you think you need to have a ServiceNow solution, which you probably tends to be like highly customizable and kind of deeply entrenched in all of your ecosystem, that's not going to be probably our forte. We can clearly go and integrate with the solutions that you have and we can provide you all the feature functionality that you most likely need, but we're not going to want to be that player. Instead, we're going to want to try to get you live really, really fast a lot through value at a really – at a good price but with a quick ROI.

In that space, we're seeing a lot of legacy, still those migrating to SaaS. I think we're considered to be number one SaaS alternative in that space under ServiceNow, and we say we're playing in that kind of mid-market low enterprise. So that is called 5,000 to 10,000 employee business range. On the low end, there's point solutions that are in there, and there's companies that are coming up and entering the different areas within the business.

What we've announced that we're also moving to ESM and so providing purpose-built solutions for other functions within the company, all built on top of our ITSM product. And that we think we already see functions that are doing that and so we know we can provide them even better experience if we actually go and research exactly – see what exactly what their needs are in a purpose-built [ph] form (14:17). And so I think that's going to be a real value add and that product is doing really well.

On our CRM product, the whole vision is about this unified view for your customer and the journey from marketing or the lead all the way down to support. And so when we relaunched Freshmarketer and Freshsales a year-and-a-half ago, we relaunched what we call the Unified Customer Record so that they're sharing a common data set across those products. We've just recently migrated our Freshchat solution on to that, so we can provide these unified experiences specifically for customers who are providing support only through conversational messaging and chat. And then we can give them this view and then tie that into systems like Shopify so that they can see the whole order history and everything else. And we think that is going provide a lot of value for our customers. And so that is for customer that we can go demonstrate to that, we can show the value, and then that's going to give us an edge on the win.

Brian Schwartz

Analyst, Oppenheimer & Co., Inc.



And then, Tyler, I just want to switch paces here, it's maybe a question on the go-to-market with the up market, the larger customers. Clearly, that's been a highlight here for the last several quarters. Can you talk about the strategy or what you're doing internally that's been driving the good growth in your 50,000 plus ARR customers?

Tyler Renwick Sloat

Chief Financial Officer, Freshworks, Inc.

A

Yeah. So we – so I've already said, we're not trying to go hunting for whales, we're not trying to go out and make a deals, but we're clearly going to engage when our customer comes inbound or we can see a quick opportunity there. We have a field presence and we've been investing in that, that's pretty traditional except for the fact that they're not like necessarily out in the field. For example, in the US, it's headquartered out of Denver, I apologize for that, out of Denver and out of San Mateo. In Europe, it's mainly out of London and out of Berlin.

That field motion, we've invested a lot in and not just on the salespeople, but traditional from an SCE and SDR perspective, but a lot in sales enablement and product marketing and training and things like that because we do think that we will continue to slowly go engage with larger customers as we get brought in. Again, we don't necessarily want to go hard, but we want to get brought in and that's going to actually be something we're going to continue to focus on. That inbound continues to feed some of that field, so the stuff that we're just doing on traditional search is continuing to feed a lot of our field motion and we want that to continue as well. And so the investments are across the board, quite frankly, and we plan to continue to make them.

Brian Schwartz

Analyst, Oppenheimer & Co., Inc.

Q

And the next go-to-market question I wanted to ask is about the multiple product strategy. Almost a quarter of the base now has more than one products here, but how do you think about going to market when you're selling into two different buyers? In certain situations you've got the IT buyer and then you've got the CRM type buyer. How do you think about increasing the penetration in the install base in terms of multiple products?

Tyler Renwick Sloat

Chief Financial Officer, Freshworks, Inc.

A

Yeah. So I would want to provide one clarification. So that multiproduct number, that includes a customer who has a desk and they're adding chat to get to omni-channel. So it doesn't necessarily mean that it's a customer who is buying one of our or two of our core three products, which is kind of desk service or CRM.

Now, we do think there's going to be a lot of value on, first, the CX side of the house or the customer facing products from our Freshmarketer or Freshsales, all the way through to Freshdesk. And part of that is when Freshdesk will be brought on to the Unified Customer Record, we'll be able to provide this seamless journey for customers today. It's integrated which – so you can have an integrated experience, but it'll be – when we bring in to the UCR, it should be fully on the common platform and we think there's going be a lot of value there. As I mentioned earlier, we already have chat that's brought on.

So we think that this is already like the first steps and we're getting there. You mentioned that there's two buyers on our employee-based products versus our CX-based products and Freshservice and Freshdesk don't necessarily have a common cross-sell. So that what we see on the [indiscernible] (18:50), we do have much customers on both products.

This is one of that we've proven success with one of the products that we have a job when they're looking at other products, just because being a vendor of choice but also a proven software. The second is for types of customers

that have inbound things around their internal offering. So these tend to be like software companies and things like that where they have a desk product that they're taking inbound from a customer that could be a ticket around, say, a bug or something like that, that's going on our software and then a natural transition over to Freshservice where they can have operations management and incident management responses that get triggered from those tickets. So we have built these types of integrations so that you can have this seamless flow from the outbound customer bringing you something, and then you have spin up a team internally to go deal with it. And that's another use case that we can prove out and show value for our customers.

Brian Schwartz

Analyst, Oppenheimer & Co., Inc.



And then in terms of international, you talked about it a little bit in the beginning. You've had to deal with all the currency and the macro impacts. But Freshworks is unique that you do have a larger presence in Europe and in the international markets than most other businesses that are selling down into new market probably goes to where the heritage and the founding of the company. Can you help our investors just maybe shed a little light on what you're seeing in terms of the different regions? Does it vary in terms of what you're seeing just on cycles or just the interest levels?

Tyler Renwick Sloat

Chief Financial Officer, Freshworks, Inc.



I don't think it varies on cycles. What we're – we've already talked about it. Europe, I think, is experiencing pressure that's greater than rest other places in the globe. I think that from the impact of, say, the war, also FX has made things tougher there. But we've been talking about that a little bit. And I think most companies have been talking about that.

You're right that we are a little bit different. Our CEO likes to say, hey, our – being founded out of India, like our first customer was an international customer, that's in Australia. And then like I think something like for two – first – 10 out of 12 are all international. As such, it had us have a global perspective from the very beginning. And when we think about go-to market, we're not necessarily just thinking about North America, we are thinking about how do we reach across the globe. And as such, we've got customers in over, I think, 120 different countries.

And it forces us to think internationally, but it also gives us the opportunity to go lean in, in all these different areas around the globe, both from an inbound perspective. So we throw this net out globally on digital marketing spend, but also on a field perspective. And so our engagement is all over the place. And we do see pockets of opportunity that we then lean in on and make sure that we want to go capture. And so we're constantly looking at that.

In general, I think SMBs right now globally are experiencing pressure. And I think that in Europe, it's worse, it's magnified. And then what we're seeing and we talked about this is that part of that pressure we see in churn which we're always going to have churn in SMB, but specifically churn on the low end of SMB, which is a lower than 50-employee businesses for us. So we already highlighted that on the call and taken that into account. And I think Europe in general is at – from SMB all the way up, we're seeing a little bit of pressure there and we highlighted that as well.

Some of that could be summer months because timing in Europe is always Q3s are always sometimes a little bit suspect depending on what their vacations are like. But we'll see as we get to the quarter.

Brian Schwartz

Analyst, Oppenheimer & Co., Inc.

Q

Fair enough. And then maybe shifting subjects here, talking about the product roadmap. How do you think about – how do you decide on your investment path between going deeper in CRM or IT or even entering a fourth application category?

Tyler Renwick Sloat

Chief Financial Officer, Freshworks, Inc.

A

Well, I think that the company has a history of innovation, and we have the privilege of being able to innovate a lot because we, number one, have access to highly technical talent pool in India, but second that talent pool is a more efficient cost. So, we can have more engineers that can produce more products.

What we do is we do protect investments across product lines. So the newer products, you have to invest in them if you want to get revenue from them in the future. So we have some products that will continue to innovate on even if they're not really contributing on the revenue side yet, we have to build those things out.

Outside of that, from a product roadmap perspective, it's only this traditional feedback loop from our customers, whether it's through customer – our customer success group that we built out or through product marketing and that feedback loop back in to feature functionality or depth of functionality that they would like to see from a customer's perspective. And we have a customer advisory panel and things like that that we will go engage.

Second is a competitive intelligence, right? Making sure that we are staying ahead of or on par with our competitors and to provide the value and then that our customers are going to want. The third is vision, Brian, just where we think things are going and having an opinion about that and a perspective. And what we clearly have had over time led by G and our product leaders. And I think a lot of that is what's driven our capability to be able to have multiple products, but deliver and have customers come into us and choose us. So, we're going to continue to do that as well.

Brian Schwartz

Analyst, Oppenheimer & Co., Inc.

Q

Maybe we could just talk about the economics of the business here. I'll bring you back to your CFO hat. The business operating with negative margins, though the unit economics are very good for the business. So, maybe you can just share with us how you think about the future leverage of the business over time, where do that comes from?

Tyler Renwick Sloat

Chief Financial Officer, Freshworks, Inc.

A

Yeah. I mean, our gross margin structure is already good. I think it's solid. We're at the low-80s, and perfect. I'm happy with that, right? We want to kind of keep it there. And I think we can get some incremental improvement. I think there's going to be some noise there.

Our G&A, we've made some pretty heavy investments over the last year. And so we're prepared to go public. And over the next couple of years, I expect to get economies of scale there. And so – and they'll be high-single digits. So, we're really talking about engineering and sales and marketing. Engineering, I already mentioned like we do invest.

We have the capability of access to talent – kind of at the low-20s. And I think that can get to high-teens over time and then eventually maybe even mid-teens depending on. We want revenue to obviously grow to be able to refuel it. And then you're really down to sales and marketing then. And the sales and marketing is just about efficiencies of what we get in for every – for what we get for every dollar we put in. And I do think we can even do better there. So we're constantly looking at that. We do invest ahead of the curve in areas like especially in the field. We're going to go build that out and then ramps up the ramp and there's an infrastructure you have to build.

And that's a lot of the journey we've been on over the last year and a half. So we're looking at that. So what would that all mean? We said we're going to be cash flow neutral to positive in Q4. And then the expectation is that we're cash flow – free cash flow positive thereafter. And there'll be maybe some variability by quarter next year. But the expectation is that, we would produce cash.

Operating profit comes after that. And we haven't given a timeframe. But what you typically see is like a year later, you could try to get to operating profit neutral. These are all non-GAAP numbers obviously on the operating profit side. But that's the way we're thinking about it. And when I think about the business, that's how I kind of break it down by the functional line items.

Brian Schwartz

Analyst, Oppenheimer & Co., Inc.



And then in terms of thinking about the M&A strategy, you mentioned you've got a very strong balance sheet. You've got over a \$1 billion in cash, no debt. In the past, the company has been acquisitive really more on the smaller level technology acquisitions that fill out the platform. With asset multiples compressing, at least in the public markets, I don't know how much in the private markets, does this change at all the appetite for M&A or the strategy that the company has moving forward?

Tyler Renwick Sloat

Chief Financial Officer, Freshworks, Inc.



I think it might. We've always been pretty open about the fact that we are open to M&A, if it makes sense. And as you described, Brian, we like – we have done deals in the past and they've tended to be kind of areas of acceleration of innovation, so where technology, the tuck-ins mainly or teams. We haven't felt the need to buy revenue. And I wouldn't expect that to change. And so we do really look at that roadmap question you gave earlier and how we decide what to build. If there's an area, we can accelerate that and do it with a great team and even add that team that – we're going to look at those things.

As you mentioned, the valuations were pretty crazy, even crazier on the private side than they were on the public side. And I do think it takes a little bit of time for that to filter through where, as you know – as public markets, there's obviously been a correction as that filters down to the private markets and as venture capitals start to have more rational term sheets and things like that. Then that's where ideas of valuation change. And so maybe we'll see that change in the private markets soon, which would then make some of the smaller companies much more attractive to bring in.

Brian Schwartz

Analyst, Oppenheimer & Co., Inc.



Tyler, we have a question here from the buy side. It's the trend in ARPU, whether that's a meaningful metric and how you think about that moving forward where there's sources of growth in ARPU in the future.

A

Tyler Renwick Sloat

Chief Financial Officer, Freshworks, Inc.

I do think it's a meaningful metric. I think the ARPU and ARPA, so I guess the ARPU in my mind would be on kind of per agent cost. The ARPA is on a per customer cost revenue and ARPA on the total customer revenue. We've seen this steady progression on ARPA for on average customer. Part of that is driven by Freshservice, which is – it's growing really, really well, and that plays in mid-market enterprise. So they tend to be larger deals.

On the ARPU, that's going to be driven by obviously via price increases that would drive it – that hasn't been on our historical to increase prices, but mainly by moving companies up addition strategy and that we have seen and companies adopting higher editions, which are higher cost because they want access to those feature functionalities and that will continue to be a strategy that we want to move forward with. We're more focused on the ARPA than the ARPU and really driving that by multiple product adoption, as well as obviously agent expansion.

Now agent expansion, which has been the biggest driver of our upsell motion, we'll see how that goes over through the rest of the year, right, as kind of the macro takes hold and a lot of companies rationalize their employee base. And so we'll see how that that plays out. Traditionally, over the last kind of year-and-a-half, it's been really consistent for us.

Brian Schwartz

Analyst, Oppenheimer & Co., Inc.

Perfect. Tyler, we've run out of time here. I know you got a lot of investor meetings to head to, but I do want to thank you for spending time and sharing the Freshworks story with us here today.

Tyler Renwick Sloat

Chief Financial Officer, Freshworks, Inc.

Yeah, Brian, as always, really appreciate it, man. And glad to be here.

Brian Schwartz

Analyst, Oppenheimer & Co., Inc.

Thank you.

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