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**Inogen, Inc.** (INGN)

Q2 2023 Earnings Call

## CORPORATE PARTICIPANTS

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**Kristin A. Caltrider**

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*President, Chief Executive Officer & Director, Inogen, Inc.*

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## OTHER PARTICIPANTS

**Colin Clark**

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## MANAGEMENT DISCUSSION SECTION

**Operator:** Welcome to Inogen's Second Quarter 2023 Earnings Conference Call. At this time, all participants are in a listen-only mode. Following management's prepared remarks, we will hold a Q&A session. [Operator Instructions] As a reminder, this conference is being recorded today, August 7, 2023.

I would now like to turn the call over to Agnes Lee, Senior Vice President of Investor Relations and Strategic Planning.

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**Agnes Lee**

*Senior Vice President-Investor Relations & Strategic Planning, Inogen, Inc.*

Thank you, Doug. Hello, everyone, and thank you for participating in today's call. Joining me on the call today are President and CEO, Nabil Shabshab; and CFO, Kristin Caltrider. Earlier today, Inogen released financial results for the second quarter of 2023. This earnings release is currently available in the Investor Relations section of the company's website along with a supplemental financial package.

As a reminder, the information presented today will include forward-looking statements including, without limitation statements about our growth prospects and strategy for 2023 and beyond, expectations related to our financial results for 2023, expectations regarding increasing productivity of our internal and external sales teams, progress of our strategic initiatives including innovation, our expectations regarding the market for our products, on our business and supply and demand for our products in both the short term and long term.

The forward-looking statements in this call are based on information currently available to us as of today's date, August 7, 2023. These forward-looking statements are only predictions and involve risks and uncertainties that are set forth in more detail in our most recent periodic reports filed with the SEC. Actual results may vary and we disclaim any obligations to update these forward-looking statements except as may be required by law. We have

posted historical financial statements and our investor presentations in the Investor Relations section of the company's website. Please refer to these files for more detailed information.

During the call, we will also present certain financial information on a non-GAAP basis. Management believes that non-GAAP financial measures, taken in conjunction with US GAAP financial measures, provide useful information for both management and investors by excluding certain non-cash items and other expenses that are not indicative of Inogen's core operating results.

Management uses non-GAAP measures internally to understand, manage and evaluate our business and make operating decisions. Reconciliations between US GAAP and non-GAAP results are presented in tables within our earnings release.

With that, I will turn the call over to Inogen's. President and CEO, Nabil Shabshab. Nabil?

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## Nabil Shabshab

*President, Chief Executive Officer & Director, Inogen, Inc.*

Thanks, Agnes. Good afternoon, and thank you for joining our second quarter 2023 conference call. During today's call, we would like to work our way through high level comments around our performance in the quarter, how that relates to our outlook for 2023, and provide an update on our progress and mitigation plans. Then we will transition to Kristin, who will walk through the details of our financial performance and our annual guidance before we take your questions at the end of the call.

In summary, while we have made progress with the execution of our commercial strategy, we are disappointed with the performance this quarter. Our revenue for the quarter fell short, mainly due to two factors: B2B headwinds, primarily with a few key accounts predominantly in the US, and slower than expected progress on our DTC productivity initiatives despite continued sequential improvements.

Considering the shortfall this quarter and understanding that our mitigation actions might take longer than expected to materialize, we are resetting expectations for revenue and adjusted EBITDA for the balance of the year.

2023 revenue is now expected to be within the range of \$315 million to \$320 million. Despite the decrease in revenue, our focus on cost containment allows us to limit the impact on adjusted EBITDA, hence expecting the full year to be a loss in the range of \$20 million to \$25 million.

I would like now to spend some time talking through factors that impacted our revenue in the quarter and the actions that we are taking. We believe patient demand for long-term oxygen therapy remains stable and is slowly recovering. However, in the B2B channel, some customers continue to face pressures relating to capital deployment, cost of borrowing while focused on margin accretion. Coupled with aggressive competitive pricing activities, this continued to impact our performance, especially with some of our larger customers.

The supply chain constraints related to semiconductor availability from mid-2021 through 2022 required us to prioritize the channels that could deliver higher revenue and margin when we were not able to fully meet market demand. This provided an opportunity for lower cost competitors to aggressively push for share gains during a prolonged but necessary period of back orders in the US B2B channel.

We were able to remediate most of the back orders by end of Q3 and into Q4 of 2022 but subsequently saw increased aggressive competitive pricing tactics into 2023. Based on our analysis, we now understand that this

backlog and the resulting circumstances had a bigger impact on some of our key accounts than we had expected. Our focus has been on regaining some of the business lost in key accounts as well as winning new customers.

Our strategy in B2B channels include delivering enduring benefits to our customers through a very strong total cost of ownership model, high patient and prescriber brand recognition, best-in-class, device quality and top tier aftersales service. Our strong value proposition is allowing us to win back some of the lost business, as well as incrementally win new accounts. We are focusing on advancing customer conviction around the benefits of the non-delivery long-term oxygen therapy model and Inogen's ability to consistently deliver value beyond the unidimensional benefits of lower acquisition price.

Additionally, our business development efforts now include the value of future partnerships with B2B customers as the result of Inogen's investment in innovations and how that could expand our customers access to patients populations and indications beyond COPD via new product introductions over the next two to four years.

We are also pleased by our recent completion of the necessary regulatory steps to allow us to commercialize our new Rove 6 as a POC with an approved eight-year expected service life. The eight-year expected service life will also cover the current G5 POC and in both cases is a critical element that further strengthens Inogen's value proposition as it relates to delivering a better return to B2B customers due to an optimized total cost of ownership.

Moving to our direct-to-consumer business, we have remained focused on scaling the new disciplines in DTC as we work towards achieving scalable and profitable growth measured through productivity per sales representative. As a result of institutionalizing the new sales disciplines in the broader DTC organization, we have delivered sequential improvements of about 30 percentage points in both unit and revenue productivity per rep with a double-digit reduction in the number of sales reps and low-single-digit reduction in marketing leads. We believe that during the remainder of 2023, our progress on the revised sales management strategy would get us closer to steady state and set us up to meet our 2024 aspirations for that channel both in terms of growth and profitability.

For our international B2B business, we continue to drive our value proposition to expand business with current customers, as well as win new ones. Our Rove 6 launch in Europe is progressing well and we have been recently notified that the last remaining signature required to publish the new reimbursement code in France has been secured. We also believe that the eight-year expected service life for Rove 6 will play a role in making Inogen's value proposition to B2B customers even stronger.

Rental revenue continues to benefit from improved prescriber team productivity with double-digit increases in referrals per sales rep as compared to Q1. We expect to continue to see steady progress as we further optimize sales territories and call frequency to drive scale per account and overall growth.

In summary, we believe headwinds in B2B are generally transient in nature and could be addressed in short to medium term by working through challenges and opportunities with existing customers while equally focusing on winning new accounts. As part of our plans to provide a path forward to revenue growth and profitability in the medium term, we are maintaining critical investments while closely managing operating expenses and adjusted EBITDA during 2023.

Part of our ongoing investments supporting organic growth are directed at expanding the patient population and indications we serve beyond COPD. Additionally, with respect to inorganic growth, upon the close of the transaction, Physio-Assist will provide an opportunity for Inogen to enter the airway clearance adjacency through a clinically differentiated offering. Physio-Assist will allow Inogen to access respiratory patients earlier and before

they require long-term oxygen therapy, hence expanding a patient's lifetime value for the company. This acquisition met our strategic, clinical, financial and capital deployment criteria and we expect to now pause our M&A efforts and upon close focus on executing on the commercial, clinical and regulatory milestones to deliver the expected returns.

I will now turn the call over to Kristin for a review of financial results. Kristin?

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**Kristin A. Caltrider**

*Executive Vice President & Chief Financial Officer, Inogen, Inc.*

Thank you, Nabil, and good afternoon, everyone. Unless otherwise noted, all financial comparisons are to the prior year comparable period. Total revenue for the second quarter of 2023 was \$83.6 million, a decrease of 19.1% versus the prior period. The decrease was driven primarily by lower international sales and lower direct-to-consumer sales, partially offset by an increase in US business to business sales and rental revenue. For the second quarter, foreign exchange net of hedging had a negative 60 basis points impact on total revenue and a negative 130-basis-point impact on international revenue. On a constant currency basis, second quarter total revenues decreased 18.5%.

Looking at second quarter revenue on a more detailed basis, domestic business to business revenue increased 63% to \$18.3 million in the second quarter of 2023, compared with \$11.2 million in the comparable period. It is important to note that the domestic business-to-business revenue was down considerably in the second quarter of 2022 due to supply constraints that limited shipments to the channel. Despite the good growth, we had expected and even larger increase in domestic B2B sales now that the supply constraints have been diminished.

International B2B sales decreased 37.8% to \$23.3 million in the second quarter of 2023, as compared to \$37.4 million in the prior period. Last year, international sales were higher as we prioritized shipments to Europe due to the pending expiration of EU MDD certificates in May of 2022. Given the tough comparable, we expected a year-over-year decrease, but sales were short of our expectations.

Direct-to-consumer sales decreased 34.1% to \$26.8 million in the second quarter of 2023, from \$40.6 million in the prior period, driven primarily by lower sales volume due to fewer inside sales representatives and lower marketing and advertising spend as we continue to drive towards improved profitability in this channel.

Rental revenue increased 8.6% to \$15.3 million in the second quarter of 2023, from \$14.1 million in the prior-year period. We have seen continued growth in rental patients on service and higher Medicare reimbursement rates. This was partially offset by rental revenue adjustments, which were part of our work to improve collections processes and clean up aged receivables.

Now on to discuss our gross margins. Total gross margin was 40.7% in the second quarter, declining 400 basis points from the prior period, as the benefit realized from lower component costs was more than offset by the impact of unfavorable channel mix and lower selling average selling prices in the US business to business channel.

Sales revenue gross margin was 38.5% in the second quarter of 2023, declining 480 basis points from the comparable period, driven primarily by shift in channel mix with a higher volume of units sold through the domestic business-to-business channel versus the direct-to-consumer and international business-to-business channels. There was additional impact due to pricing pressure due to price pricing pressure in the B2B channel. This was partially offset by lower premiums paid for components.

Rental revenue gross margin was 50.5% in the second quarter of 2023 versus 54.2% in the prior period, a decline of 360 basis points. The margin compression was primarily driven by higher patient servicing costs and the onetime impact of rental revenue adjustments, partially offset by higher Medicare reimbursement rates.

Moving on to operating expense. In Q2, total operating expense decreased to \$45.8 million, compared to \$49.1 million in the prior period, representing a decrease of 6.8%. The reduction in spend is a result of the steps we have taken to mitigate the impact of the macroeconomic headwinds we have encountered in 2023. The current quarter included restructuring and other related charges of \$200,000 and acquisition-related costs totaling \$500,000. Excluding the onetime charges, operating expense decreased to \$45.1 million, representing a reduction of 11.8% as compared with the prior period. Of note, excluding onetime charges, operating expense was reduced by \$5.1 million compared to the first quarter of 2023.

Going into more detail on our expenses in the second quarter, we have continued to work on our innovation pipeline through investment in research and development, with a total spend for the quarter of \$4.3 million. This spend was 29.2% lower than the second quarter of 2023, primarily due to a decrease in amortization of intangible assets.

Sales and marketing expense in the period was \$26.9 million, representing an 11.5% decrease over the prior year. The \$3.5 million reduction in spending was primarily driven by lower personnel-related and media and advertising costs associated with our direct-to channel.

And finally, we incurred \$14.6 million for general and administrative expenses in Q2, representing a \$1.9 million increase as compared to the prior period driven primarily by a \$2 million increase associated with the prior-year benefit from a change in fair value of earnout liability.

As previously mentioned, we incurred \$200,000 for restructuring charges, as well as \$500,000 in acquisition costs for diligence and legal activities associated with the Physio-Assist purchase agreement. This was partially offset by a decrease in personnel-related expenses.

In the second quarter of 2023, we reported a net loss of \$9.8 million and a loss per diluted share of \$0.42. On an adjusted basis, we reported a net loss of \$5.8 million and an adjusted loss per diluted share of \$0.25. Adjusted EBITDA was a \$3.2 million loss, a sequential improvement from the first quarter of 2023, which reported an adjusted EBITDA loss of \$11.8 million. This improvement is correlated with increased revenues and cost-saving actions that we have taken in the first six months of the year.

Moving on to our balance sheet, as of June 30, 2023, we had cash, cash equivalents and marketable securities of \$170.1 million with no debt outstanding. We continue to carry inventory of premium priced components for semiconductor chips purchased on the open market but not yet sold in finished goods. These items reside on the balance sheet as inventory and as prepaid expense in other current assets.

As of June 30, 2023, the value of premium components in our inventory and prepaid balances was \$8.6 million. Due to the lower forecasted sales volumes, we now expect the cost for premium price components to continue to impact cost of goods sold through Q4 2023 and potentially into early 2024.

I will now turn to our financial outlook. As Nabil mentioned, we are updating our guidance to reflect our year-to-date results and have adjusted expectations based on the challenges we have encountered in our business-to-business channel as well as our direct-to-consumer channel. We now expect total company revenue for the full year 2023 to be in the range of \$315 million to \$320 million.

Despite the large decrease in revenue, our recent cost reduction efforts will allow us to deliver an adjusted EBITDA loss in-line with current street expectations in the range of a \$20 million to \$25 million loss for the full year 2023. We remain focused on a return to profitability and we will continue to actively manage our expenses for the remainder of the year.

And with that, we will be happy to take your questions.

## QUESTION AND ANSWER SECTION

**Operator:** Thank you. Ladies and gentlemen, at this time we will be conducting a question-and-answer session. [Operator Instructions] Our first question comes from the line of Mathew Blackman with Stifel. Please proceed with your question.

**Colin Clark**

*Analyst, Stifel, Nicolaus & Co., Inc.*

Q

Hi. This is Colin on for Matt. I just wanted to start with one on guidance. What does the guide imply in the broader context of your efforts to turn around the various business lines? Are things just moving slower than you guys anticipated or are you encountering new challenges that you may not have foreseen? For example, has anything changed regarding your rep productivity outlook? Thanks.

**Nabil Shabshab**

*President, Chief Executive Officer & Director, Inogen, Inc.*

A

Thank you, Colin. I'll take I'll take the question. So, we are not seeing any new challenges to your point. In terms of rep productivity, like we indicated, there is a very healthy productivity increase Q2 versus Q1 in the DTC channel as well as the prescriber channel. The challenges with respect to the new guideline mainly relates to B2B and a slower progress in terms of DTC revenue generation. And that is directly related to the lower number of people in the seats. And as a reminder, we had focused on trying to actually achieve both growth and profitability in that channel. The progress is albeit a little bit slower, but the productivity per rep is actually where we expected it to be and is very encouraging in that channel. Again, from my perspective, the B2B challenges are a little bit more pronounced even though there are some in DTC, but the encouraging productivity indications are very positive for us.

**Colin Clark**

*Analyst, Stifel, Nicolaus & Co., Inc.*

Q

Okay. And given those B2B dynamics you just mentioned, should we expect 3Q to take a step back from the second quarter before things kind of start getting a little bit back on track in the fourth quarter? Just what should we expect from a cadence standpoint there?

**Nabil Shabshab**

*President, Chief Executive Officer & Director, Inogen, Inc.*

A

Yeah, potentially, there might be a small step back in in Q3. I think maybe. Let me elaborate a little bit. So as we work through some of the challenges but also the opportunities, like we said in the prepared remarks with our large B2B customers, it might take a little bit longer than we expected that's why we've been very judicious about calling down the number. With that said, we're seeing good progress and the ability to win back some of the



accounts that we had lost, as well as promising progress in terms of winning new accounts. And now some of the losses are in larger, more concentrate accounts, like we mentioned also in our remarks. But there is nevertheless progress. We think it will take a little bit longer than we expected.

**Colin Clark**

*Analyst, Stifel, Nicolaus & Co., Inc.*

Okay. Thank you.

Q

**Nabil Shabshab**

*President, Chief Executive Officer & Director, Inogen, Inc.*

Thanks, Colin.

A

**Operator:** Our next question comes from the line of Robbie Marcus with JPMorgan. Please proceed with your question.

**Lilia-Celine B Lozada**

*Analyst, JPMorgan Securities LLC*

Hi. This is actually [ph] Lily (23:15) on for Robbie. Thanks for taking the question. Can you talk a little bit more about what you're seeing in DTC? It sounds like productivity is improving, so I guess head count is really the issue there. So, when can we expect turnover to start stabilizing and how are you thinking about the size of the sales force growing from here?

Q

**Nabil Shabshab**

*President, Chief Executive Officer & Director, Inogen, Inc.*

Yeah. Thank you, [ph] Lilly (23:36). I'm going to go back to maybe comments that we've made publicly before. Just as a reminder, we used to be in the 300 range in terms of salespeople. We had indicated recently that we're going to be closer to the 200 range, give or take here, plus or minus 10%.

A

To your point specifically, the productivity actually is very encouraging. It's plus 30% both in terms of unit productivity as well as revenue productivity per rep. The number of reps in the seats, naturally as you dial up the accountability and the new expectations, there is a little bit more churn and that we had expected, but it's not that all of it is regrettable, in all honesty.

But to go back into your other part of the question, where do we think this is going to stabilize as part of our long range plan early in 2024, we will give an indication of where we think that channel will be. But with that said, DTC will always be part of our go-to-market strategy. It's a unique channel that differentiates us. What we were trying to do and we are making progress against that is to get to the right balance between growth but at the right price from a profitability perspective. Hence, as we mentioned, there's a reduction in salespeople in the seats as well as a reduction in advertising spend in terms of the needs that we generate and an effort to continue to compensate for some of that revenue through increased productivity that we're good progress on.

**Lilia-Celine B Lozada**

*Analyst, JPMorgan Securities LLC*

Got it. That's helpful. And then just as a follow-up, can you give us an update on the state of the supply environment? Do you feel you have good visibility through the rest of the year? And when do you think you can get back to normal ordering patterns with your suppliers? Thanks so much.

Q



**Nabil Shabshab**

*President, Chief Executive Officer & Director, Inogen, Inc.*

A

Yeah. So the state of the supply in general is, I think, trending normally. There are no huge red flags. There are a few issues here and there with very specific products that we're trying to source, but I would not characterize that as a major concern for us unless something material changes moving forward, which we don't expect it to be. So we're not in a supply-constrained environment in general.

Q

Great. Thank you.

**Nabil Shabshab**

*President, Chief Executive Officer & Director, Inogen, Inc.*

A

Thanks, [ph] Lily (25:49).

**Operator:** Our next question comes from the line of Matthew Mishan with KeyBanc Capital Markets. Please proceed with your question.

**Brett Fishbin**

*Analyst, KeyBanc Capital Markets, Inc.*

Q

Hey, guys. This is Brett on today for Matt. Thanks so much for taking the questions. Wanted to start off on a question regarding the Rove 6 announcement this morning that you touched on during the prepared remarks as well. I'm just curious if you could walk through what's changing around the value proposition given the extended service life. And as a follow-up there, does that mean that the product will now have an eight-year warranty? And does anything change around the economics for Inogen around ASPs or warranty revenue given the improvement there?

**Nabil Shabshab**

*President, Chief Executive Officer & Director, Inogen, Inc.*

A

Yeah. Thank you, Matt. I'll take that question also. So let me start with the characterization. So Rove 6 is an update of G5, but it's very important for us to actually think of it as the new platform for the innovation that we said is coming around 2024 in terms of a larger than six-setting device. So, the improvements in this device are basically through the user interface, the alarming capability as well as the cannula placement.

So with that said, we also managed to achieve an eight-year service of a life expected service life, which is really critical. If you're a B2B customer and you're thinking about the return on that invested capital that you have in the fleet of POCs, it's very important for you to be able to buy a device that is approved and has a label of eight years from a regulatory perspective versus a five-year label. So we're very excited about the fact that the value proposition we're trying to drive before continues to get stronger and to our knowledge, we don't know of any other devices that have an eight-year expected service life yet in the marketplace. So, that's very important for us. And that applies both here as well as in Europe.

Back to your question about the warranty, we don't have an intention to extend the warranty beyond the five years in the sense that people can potentially -- like today we have a three-year and a five-year warranty on the five-year device and we believe that we're going to stay within the five-year warranty, but we will allow we will

ourselves service those devices after warranty expires, as well as allow the key large customers, like they do now service their own devices by providing them with the right parts and service support.

**Brett Fishbin**

*Analyst, KeyBanc Capital Markets, Inc.*

Q

All right. Got it. That's very helpful. And then just this might be a little bit of a tough one to answer, but just trying to maybe take a step back, can you maybe touch on just from an underlying patient demand perspective, especially in the direct-to-consumer channel, stripping back some of the changes in sales force levels? What can you say about just the level of demand, especially as we proceeded into the summer months when you typically would see a step-up? Like, are there any positive maybe early signs you could point to that that would give a little more positivity on what we might see into next year at a lower number of sales reps?

**Nabil Shabshab**

*President, Chief Executive Officer & Director, Inogen, Inc.*

A

Yeah. So Brett, thanks for the question. I think let me start with the DTC channel that you sort of called out first. And the positive I can see there is as a reminder, we took the price increases successively in the last year and a half. Despite that, through productivity and the ability to continue to serve the patients that don't have any option in terms of insurance-based coverage, we see that the demand continues to be there despite the price increases that we've taken, which are honestly intended to price for value more than anything else and they were partially intended to cover the premium pricing for semiconductors. So from a demand perspective, I don't see any softness in that.

I think let me transition to the other part of the business. With respect to demand in B2B, in general, if you look at the prescription rates of people that are getting diagnosed and prescribed, it's actually steady and recovering slowly. So, from a patient perspective, the demand is there. What we saw in the quarter and in the preceding quarter is a little bit of softness in terms of the B2B customers and their willingness, like we said, in the prepared remarks, to deploy capital at the cost of borrowing, as well as making sure that they get a return on that capital. But then again I would label it transient in nature where people sort of looked the other way about acquisition price and now are starting to slowly turn around and saying there's a different way to look at this model. So we believe that demand will slowly start getting back on track into what we believe is a normal level of demand in the B2B channel also.

**Brett Fishbin**

*Analyst, KeyBanc Capital Markets, Inc.*

Q

All right. Thanks so much for taking the questions.

**Nabil Shabshab**

*President, Chief Executive Officer & Director, Inogen, Inc.*

A

No worries, Brett.

**Operator:** There are no further questions in the queue.

**Nabil Shabshab**

*President, Chief Executive Officer & Director, Inogen, Inc.*

Okay. Perfect.

**Operator:** I'd like to hand it back to Mr. Shabshab for closing remarks.

## Nabil Shabshab

*President, Chief Executive Officer & Director, Inogen, Inc.*

Thank you. In the near term, we are focused on improving our commercial execution, strengthening our portfolio through innovation beyond COPD and positioning the company for sustainable growth and profitability. Our transformational journey continues and we remain committed to driving value for our patients, customers and shareholders over the medium to long long-term organically and with an expanded portfolio including airway clearance solutions.

As I conclude, I would like to thank our investors for your support and your interest in Inogen. I'm extremely proud of the Inogen team's collective effort to work through these short-term challenges, continually improving our execution while building needed capabilities, fulfilling our purpose of improving patient lives through respiratory care while driving growth and eventually profitability remains an exciting true north for all of us. Thank you again and enjoy your afternoon.

**Operator:** Ladies and gentlemen, this does conclude today's teleconference. Thank you for your participation. You may disconnect your lines at this time and have a wonderful day.

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