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Hilton Worldwide Holdings, Inc. (HLT)

Q3 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning and welcome to the Hilton Third Quarter 2021 Earnings Conference Call. All participants will be in a listen-only mode. [Operator Instructions] Please note, this event is being recorded.

I would now like to turn the conference over to Jill Slattery, Senior Vice President, Investor Relations and Corporate Development. You may begin.

Jill Slattery

Senior Vice President-Investor Relations and Corporate Development, Hilton Worldwide Holdings, Inc.

Thank you, Chad. Welcome to Hilton's third quarter 2021 earnings call. Before we begin, we would like to remind you that our discussions this morning will include forward-looking statements. Actual results could differ materially from those indicated in the forward-looking statements, and forward-looking statements made today speak only to our expectations as of today. We undertake no obligation to publicly update or revise these statements.

For a discussion of some of the factors that could cause actual results to differ, please see the Risk Factors section of our most recently filed Form 10-K. In addition, we will refer to certain non-GAAP financial measures on this call. You can find reconciliations of non-GAAP to GAAP financial measures discussed in today's call in our earnings press release and on our website at ir.hilton.com.

This morning, Chris Nassetta, our President and Chief Executive Officer, will provide an overview of the current operating environment. Kevin Jacobs, our Chief Financial Officer and President, Global Development, will then review our third quarter results. Following their remarks, we'll be happy to take your questions.

With that, I'm pleased to turn the call over to Chris.

Christopher J. Nassetta

President, Chief Executive Officer & Director, Hilton Worldwide Holdings, Inc.

Thank you, Jill. Good morning everyone and thanks for joining us today. We are pleased to report another quarter of very solid results that demonstrate continued recovery and the resiliency of our business model. Increases in vaccination rates and consumer spending, coupled with improving business activity, continued to drive solid travel demand throughout the summer and into the fall. As global borders reopen and the travel environment recovers, we remain extremely encouraged by people's desire to travel and connect more than ever before.

In the third quarter, system-wide RevPAR grew 99% year-over-year. Compared to 2019, RevPAR was down roughly 19%, improving 17 percentage points versus the second quarter, with system-wide rates down just 2.5% versus 2019.

Adjusted EBITDA totaled approximately \$519 million, up 132% year-over-year and down 14% versus 2019. Performance was primarily driven by strong leisure trends, with leisure room nights roughly in line with 2019 level, with leisure rates exceeding 2019 levels.

Business travel continued to gain momentum, with midweek occupancy and rates improving meaningfully versus the second quarter. In the quarter, business transient room nights were roughly 75% of prior peak levels. Group

continued to lag, but showed significant sequential improvement versus the second quarter, boosted by strength in social events.

For the quarter, group RevPAR was approximately 60% of 2019 levels, improving 21 percentage points from the second quarter. Overall, system-wide RevPAR versus 2019 peaked in July at 85%, with rates just shy of prior peaks. As expected, recovery slowed modestly later in the quarter due to typical seasonality and customer mix shift, but overall trends remain solid. Both August and September RevPAR achieved roughly 80% of 2019 levels, driven by continued strength in leisure and upticks in business travel post Labor Day as offices and schools reopened. These trends improved modestly into October, with month-to-date RevPAR at approximately 84% of 2019 levels and rates in the US nearly back to prior peaks.

Roughly 40% of system-wide hotels have exceeded 2019 RevPAR levels in October month-to-date. Additionally, bookings for all future periods are just 8% below 2019. With loosening travel restrictions and strong nonresidential fixed investment forecast, we remain optimistic for future travel demand. TSA reported third quarter travel numbers were nearly 80% of 2019, with demand picking up further following the announcements of the US border reopening and the lift of the international travel ban for vaccinated travelers.

Additionally, studies show that nearly 70% of US businesses are back on the road, up 28 points from the end of the second quarter. With roughly 80% of our typical corporate mix coming from small and medium sized businesses and with the lagging recovery of larger corporate travel, we've taken the opportunity to continue our work from before COVID to further increase our focus on this segment of demand. This demand is higher rated, the more resilient – the resilient, which has helped us to recover more quickly in business transient and should drive rate compression in the future as larger corporate travel picks up.

On the Group side, our position for the rest of the year remains fairly steady, with forward booking sentiment improving as variant concerns taper. Additionally, the recent re-openings of some of our large urban properties like the, New York Hilton Midtown, increased our confidence in our positioning as group recovers.

Turning to development we added nearly 100 hotels and 15,000 rooms across all major regions and delivered strong net unit growth of 6.6% in the third quarter. Conversions represented roughly a third of openings. Year-to-date, we've added more than 42,000 net rooms globally, higher than all our major branded competitors.

Our performance reflects the success of our disciplined growth strategy, the strength of our brands, network effect and commercial engines across the world. It also illustrates our increasing confidence in a strong recovery in global tourism in the months and years to come.

During the quarter, we launched our large-scale franchise model in China, enabling independent owners to explore franchising opportunities with our Hilton Garden Inn brand, with a prototype developed specifically for the Chinese market. To-date, we have signed more than 100 deals to develop Hilton Garden Inn properties in China, strengthening our confidence in the long-term growth of our focused service brands and our ability to cater to a growing middle class.

Following our recently announced exclusive license agreement with Country Garden, we were thrilled to open our first Home2 Suites in China. With plans to grow to more than 1,000 properties, we look forward to leveraging our partnership to capture the rapidly growing demand for mid-scale hotels in China. We also celebrated the opening of our 500th Home2 Suites following the brand's launch just 10 years ago, making it one of the fastest-growing brands in industry history, and boasting the industry's largest pipeline in North America with more than 400 hotels in development. Our luxury and lifestyle footprints also continued to expand globally with the debut of the Canopy

by Hilton in Spain and the highly anticipated opening of the Mango House, LXR in the Seychelles. Marking another important milestone in its global expansion, LXR celebrated its debut in Asia Pacific with the opening of the ROKU KYOTO.

In the quarter, we signed nearly 24,000 rooms, up approximately 40% year-over-year, driven by strength in the Americas and Asia Pacific regions. Driving our positive momentum in luxury, we announced the signing of the Conrad Los Angeles, the brand's first property in California. The 300-room hotel is expected to open in 2022 as part of the Grand L.A. mixed-use development.

With approximately 404,000 rooms in development, more than half of which are under construction, we expect positive development trends to continue, driven by both new development and conversion opportunities. For the full year, we expect net unit growth in the 5% to 5.5% range and we continue to expect mid-single-digit growth for the next several years.

For our guests, flexibility has always been important, but the pandemic has made choice and control even more critical. We were excited to launch several new commercial programs and loyalty extensions, including the launch of Digital Key share, a first for a major hospitality company. This feature allows more than one guest to have access to their room's digital key.

Additional technology enhancements have enabled our Elite Honors members to begin enjoying automatic room upgrades. Gold and Diamond members may be notified of a complementary upgrade prior to arrival, enabling guests to choose their upgraded room directly by using the Hilton Honors app. We continue to focus on new opportunities to further engage our 123 million Honors members, and are thrilled to see engagement is nearly back to 2019 levels.

In the quarter, membership grew 11% year-over-year. Honors members accounted for 59% of occupancy, with the US at 66%, just 2 points below 2019 levels. During the pandemic, approximately 23 million US households brought home a new pet, including my own. And like so many others, my family loves traveling with our new dog, Miller.

In the coming months, Homewood Suites will join Home2 in becoming 100% pet-friendly in the US, with plans for all limited service brands to be pet-friendly by the first quarter of next year. And thanks to our exciting partnership with Mars Petcare, we're offering new pet focused programming and benefits. Our guests are eager to travel with their furry little friends. And by making that simpler, we're able to capture demand and bring new business into the system.

As the global travel environment improves, I continue to be impressed by our team members' dedication to providing exceptional experiences to our guests. That's why I am particularly proud that, last week, we were named the number three World's Best Workplace by Fortune and Great Place to Work. After six consecutive years of being ranked, Hilton was the only hospitality company on the list. We truly believe that Hilton continues to be an engine of opportunity for all of our stakeholders around the world and are very optimistic for the future.

With that, I'll turn the call over to Kevin for a few more details on our results in the quarter.

Kevin J. Jacobs

Chief Financial Officer & President, Global Development, Hilton Worldwide Holdings, Inc.

Thanks, Chris, and good morning, everyone. During the quarter, system-wide RevPAR grew 98.7% versus the prior year on a comparable and currency neutral basis as the recovery continued to accelerate, driven by strong

leisure demand, particularly in the US and across Europe. Performance was driven by both occupancy and rate growth. As Chris mentioned, system-wide RevPAR was down 18.8% compared to 2019.

Adjusted EBITDA was \$519 million in the third quarter, up 132% year-over-year. Results reflect the broader recovery in travel demand. Management and franchise fees grew 93%, driven by strong RevPAR improvement and Honors license fees. Additionally, results were helped by continued cost control at both the corporate and property levels. Our ownership portfolio performed better than expected in the third quarter, driven by the accelerating recovery in Europe, the Tokyo Olympics and ongoing cost controls. For the quarter, diluted earnings per share, adjusted for special items, was \$0.78.

Turning to our regional performance, third quarter comparable US RevPAR grew 105% year-over-year and was down 14% versus 2019. Robust leisure demand and improving business transient trends drove strong performance in July. Trends modestly slowed later in the quarter due to seasonality. US occupancy averaged nearly 70% for the quarter, with overall rate largely in line with 2019 levels.

In the Americas outside the US, third quarter RevPAR increased 168% year-over-year and was down 30% versus 2019. The region benefited from easing travel restrictions and strong leisure demand over the summer period. Canada also saw noticeable step-up in demand in August after reopening their borders to vaccinated Americans.

In Europe, RevPAR grew 142% year-over-year and was down 35% versus 2019. Travel demand accelerated across the region in the third quarter as vaccination rates increased and international travel restrictions loosened.

In the Middle East and Africa region, RevPAR increased 110% year-over-year and was down 29% versus 2019. Performance benefited from strong domestic leisure demand and international inbound travel from Europe.

In the Asia Pacific region, third quarter RevPAR grew 5% year-over-year and was down 41% versus 2019. RevPAR in China was down 25% as compared to 2019 as a rise in COVID cases led to reimposed restrictions and lockdowns across the country. China has recovered steadily into October, with occupancy nearing 60% for the month. In the rest of the Asia Pacific region, prolonged lockdowns in Australia and New Zealand offset upside from the Tokyo Olympics.

Turning to development, as Chris mentioned, in the third quarter, we grew net units 6.6%. Our pipeline grew sequentially, totaling 404,000 rooms at the end of the quarter, with 62% of pipeline rooms located outside the US. Development activity continues to gain momentum across the globe as the recovery progresses, a testament to the confidence owners and developers have in our strong commercial engines and industry leading brands. For the full year, we now expect signings to increase in the mid to high teens range year-over-year and expect net unit growth of 5% to 5.5%.

Turning to the balance sheet. We ended the quarter with \$8.9 billion of long-term debt and \$1.4 billion in total cash and cash equivalents. We're proud of the financial flexibility we demonstrated over the past 18 months. And looking ahead, we remain confident in our balance sheet management as we continue to progress through the recovery and move closer towards our target leverage.

Further details on our third quarter can be found in the earnings release we issued earlier this morning.

This completes our prepared remarks. We would now like to open the line for any questions you may have. We would like to speak with all of you this morning, so we ask that you limit yourself to one question.

Chad, can we have our first question, please?

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] And the first question will come from Carlo Santarelli with Deutsche Bank. Please go ahead.

Carlo Santarelli

Analyst, Deutsche Bank Securities, Inc.

Q

Hey, Chris, Kevin, everybody. Thanks for taking my question.

Christopher J. Nassetta

President, Chief Executive Officer & Director, Hilton Worldwide Holdings, Inc.

A

Hey, good morning, Carlo.

Carlo Santarelli

Analyst, Deutsche Bank Securities, Inc.

Q

Good morning. Chris, you gave a lot of color, as did you, Kevin, in your prepared remarks. But one thing I just wanted to kind of ask around was, how you guys are seeing or believe the cadence of business transient travel will play out here in the fourth quarter? And how, kind of – or how you're thinking about the sequencing through 2022?

Christopher J. Nassetta

President, Chief Executive Officer & Director, Hilton Worldwide Holdings, Inc.

A

Yeah. I mean, great question, Carlo, and obviously, one everybody is interested in. So, maybe I'll talk about all the segments a little bit, because it's hard to do one without the others.

Carlo Santarelli

Analyst, Deutsche Bank Securities, Inc.

Q

Sure.

Christopher J. Nassetta

President, Chief Executive Officer & Director, Hilton Worldwide Holdings, Inc.

A

So, to grossly oversimplify, which I like to do occasionally, the way I would see it is, as we have been seeing through the third quarter and what I think we'll see in the fourth quarter is a continued uptick in business transient travel. I think that will come from all segments of business transient. But again, probably continue to be led this – in this year in the fourth quarter by small and medium SMEs, small and medium enterprises.

I don't think you'll see a huge pickup, but I think you'll see a modest pickup. At the same time, just because people are increasingly back in offices and kids are definitely mostly, if not entirely, back in school, I think, you'll see a little bit of a tick down in leisure business.

Now the weekends will continue to rage. I think, the weekends have been extraordinary. But the mid-week leisure travel will continue to tick down. And I think, those two will largely offset each other in the fourth quarter.

I think, group will remain pretty consistent. Obviously, we had a big uptick in the summer and then Delta variant sort of slid out the momentum a little bit on group. People think there's advanced planning. People have to spend money. And so, while there's plenty of group occurring, it's really largely sports and social at this point.

I think that continues about – like, what we've seen in the third quarter into the fourth, because people are – all the pent-up demand is there, but people are sort of advanced planning more into next year just to sort of finally get through Delta, and hopefully, to the endemic stage of COVID, which sort of feels like is, we're in the process of doing as we speak.

As we think about 2022 with all those segments, what I would say is, I think, leisure will remain elevated relative to historical standards. Obviously, my belief is, kids will still be back in school. More offices are going to open. So mid-week, we'll get back to more normalized levels.

But I think the weekends, people want to be out. That turns out they didn't like being locked in their closets and basements and attics, and so they're going to want to get out. And we've seen this pattern of very high demand on weekends. I think that will continue.

And so, I think on the margin, leisure will be – continue to be stronger than we've historically seen sort of in pre-COVID times. I think, business transient will continue to move up. You'll continue to see great strength in small and medium enterprises, which aren't fully back to pre-COVID, but getting pretty close. And my own belief is, you'll start to see the large corporate step into the game. I mean, they're already in the game, but they're still sort of like 40% off of 2019 levels. So, I think, you'll see a step change in the large corporates which will contribute along with SMEs to continued upticks in business transient.

And then I think group is clearly going to be better next year than this year. I think reality is the first quarter probably is typically a slow group quarter. I don't think it will be different in that way. I think people are going to want to sort of clear the mechanism of getting past the winter, you know, just because concerns of flu seasons and all that, given what we've all been through.

But I think as you get into Q2, Q3 and Q4, both booked business and realized business on the group side are going to be better. So, I think, 2022 is sizing up to be – I think, the fourth quarter is sizing up to be fairly similar to the third quarter. And I think, 2022 is sizing up to be another big step forward on recovery to more normalized times.

Carlo Santarelli

Analyst, Deutsche Bank Securities, Inc.

Q

Thank you, Chris. That's helpful. That's it from me.

Christopher J. Nassetta

President, Chief Executive Officer & Director, Hilton Worldwide Holdings, Inc.

A

Thanks Carlo.

Operator: And the next question comes from Joe Greff from JPMorgan. Please go ahead.

Joseph Greff

Analyst, JPMorgan Securities LLC

Q

Good morning, Chris, Kevin and Jill. You guys were – had some interesting comments on the development side, and obviously, positive there. Chris, when do you think hotel constructions – construction starts trough? When do you think new signings [indiscernible] (21:31) or have they?

Christopher J. Nassetta

President, Chief Executive Officer & Director, Hilton Worldwide Holdings, Inc.

A

Yeah. Another we've spent a lot of time looking at that through the last couple of quarters and very recently. Here's what I'd say. I gave you a sense, so I won't repeat what both Kevin and I said about NUG. Kevin, we both talked about it this year. I gave you a sense in our prepared comments that we think we'll be in the mid-single-digits for the next couple years. Obviously, that requires a lot of work. It requires signing deals, starting construction that then ultimately it lands in our NUG numbers.

I think when you look back 2 years from now at this period of time, I am of the mind and reasonably confident that what you will see is the trough in deal signings was last year. As Kevin mentioned, we're going to be up in the mid to high single-digits in signings this year, we think. I mean, we're not done with the year. We always have a good flurry of activity at the end, but we got a lot of it on the books. And so, we're pretty damn confident we're going to be up nicely. And I don't see why next year, given what's going on in the environment in terms of particularly operating recovery, pricing power which I'm sure we'll come to, we'll do it maybe in another question, that we're going to see more deals signed next year.

So, I think last year was probably, in my mind, the trough for signings. I think, this year, for those same exact reasons, will be the trough in construction starts. Starts always will lag the signings a little bit. We're definitely going to be a little bit modestly down in signings this year after being down last year. Our expectation is that will turn around next year. And that's why we think we'll be sort of in the mid-single-digits for a couple years and then back on track being in the 6% to 7% range, just because starting this year we're signing more. Starting next year, we're starting more. We're obviously filling in a lot.

And you saw in the second quarter, a third of our NUG was conversion. So, we're filling in. And so, between all of those factors, we think, ultimately, when we get out past a couple years, we're back. The goal is to be back in the 6% to 7%. And I think given what I see in the environment, that we feel pretty good about that. I mean – and I'll probably stop there with the only comment being, things are going to come back faster than prior recoveries here. And that's because the thing it's very different than every other cycle I've seen in my 40 years, and I'll leave it at this, and somebody will, I'm sure, have a question, is just pricing power.

I mean the reality is, typically, it's like a grind to build back occupancy and rate lags significantly. Rate is leading the charge, and that obviously flows really nicely. We've done a bunch of things, as you know. We've talked about a lot to create higher margin businesses out of all of these brands. And when you flush all that through, even with labor costs up and all of those fun things, these are higher margin businesses. And part of this is just we're in an inflationary environment.

And guess what? We can reprice our product every second of every day, where we're a very good hedge in that way to inflation. And we're being very thoughtful about how we're pricing our product. And so, I think when we all look back on it, this will be a faster recovery on the development side than we've seen in prior cycles. And so, I think, we're going to be back in – on a very nice trajectory next year.

Joseph Greff

Analyst, JPMorgan Securities LLC

Q

Thank you.

Operator: The next question will be from Shaun Kelley from Bank of America. Please go ahead.

Shaun C. Kelley

Analyst, BofA Securities, Inc.

Hi, good morning, everyone.

Christopher J. Nassetta

President, Chief Executive Officer & Director, Hilton Worldwide Holdings, Inc.

Hey, Shaun.

Shaun C. Kelley

Analyst, BofA Securities, Inc.

Hey, Chris, I think there are a couple of fat pitches there on the pricing environment, so maybe I'll bite, if you could. But I guess my twist would be, could you give us a little color specifically on the business pricing side? I think, we all see that the leisure rates are exceptional. And so maybe your thoughts on how long leisure can continue pricing like it is, your thoughts on the recovery of business pricing. And then any headwind from large corporates, you've done a great job of delineating small and large. So how much of a headwind is large corporate? Does that price any differently? Is that a factor at all?

Christopher J. Nassetta

President, Chief Executive Officer & Director, Hilton Worldwide Holdings, Inc.

Yeah. A great question. Yes, I did sort of serve that up. So, I guess I shouldn't be surprised of getting asked. Listen, you embedded in the question is part of the answer. But, obviously, we feel – first of all, let me not be pedantic, but say what I say a lot when I'm asked this question. The laws of economics are alive and well, right? And that's what's going on. Why is leisure so strong in rate? Why are we able to price above historically high levels? Because there are crazy amounts of demand. Like our weekend demand is off the charts.

We're running 85% to 90% system-wide in the US on the weekends. And we're pricing over 2019 levels, obviously, because we have a lot of demand. I do think that will – that leisure pricing power will continue because, what I said before, I believe that leisure demand is going to remain at elevated levels, particularly on the weekends, and that that's going to give us nice pricing power.

Even though, obviously, the recovery in business transient has lagged, as I said in the quarter, we were 75%, but it's a tale of two cities, which is, I implied it a little bit. You have the big corporates, which are still 40% off. But then you have small and medium, which are only maybe 10%. You could even argue maybe 5% or 10% off. And so, we have a fair amount of pricing power in the biggest piece – in the biggest segments, and they are less price sensitive. So, broadly, your biggest – it's not everybody. Your biggest corporate customers can end up with sort of off bar, 10% or 20%. Small and medium might end up at 5% or 7%. So, that's why we were working so hard on accessing more of that demand base pre-COVID and it has helped us during COVID.

And so, when you put it all together and you look at like even in the quarter, we're at 90% of 2000 – in business transient combined, we're already at 90% of 2019 levels even though we still have a ways to go to build back demand. So, I feel – it's a long way to it. I feel pretty good about where that's going because we're going to keep pushing on small and medium. That's almost back. My guess is that will exceed prior levels. And then the

corporates are going to come in. And that's going to allow us to put more on the top of the funnel to price – have more demand, allows us to price more aggressively.

I think, when it's all said and done, if we were 80-20 before, and I don't know exactly where it will be, but my suspect we will probably never go back to 80-20 in reality because we have been successful at finding other segments that we think are going to be there. They're going to be more resilient and they're going to be higher priced. So, my guess is we will be managing to probably a 90-10 world or something like that. But we do think pricing power is not in business transient what it is in leisure, but it's not far off.

And then group, group is sort of in the year, for the year, similar to business transient. But as you look forward, because there's so much pent-up demand, and as I've talked about at least on the last call, we're actually pricing already over 2019 levels. So, there's pricing power. And you'd say, well, wow, if group is still way off from a consumer revenue point of view, what's going on?

Well, what's going on is group is very – the one segment that books way in advance and there's a limited amount of meeting space in the world and in the United States. We happen to have a lot of it. I mean, there are a few of us that are very big players in that space. A lot of people want it. And so, the reality is, again, laws of economics are alive and well. People want it. There's not enough of it. You have huge pent-up demand that's sort of getting all – events that didn't happen, that need to happen, new events. And that's pushing into next year.

And so even though in the moment, group revenues aren't what they were, on a forward-looking basis, there is a good amount of pricing power, which is why on a – all of our advanced bookings into next year are pricing over 2019 levels at this point.

So, again, back to the bait I put out there, I guess, it's unusual. Like I hate to admit how long I've been doing this, but a long time. I guess I said it before. But it just hasn't really happened this way. Now, there are a lot of reasons. We're better, right? We got much more sophisticated revenue management systems. We're much more on top of it, I think, than we've ever been. Obviously, we're in a more inflationary environment broadly. Thank you, Federal Reserve and the US Congress, for fiscal and monetary stimulus; we could debate transitory or otherwise. But those things are translating into broadly a more highly inflationary environment. And that applies to us too, and that obviously is helping from a pricing power point of view.

Shaun C. Kelley

Analyst, BofA Securities, Inc.

Q

Thank you very much.

Operator: The next question will be from Thomas Allen from Morgan Stanley. Please go ahead.

Thomas G. Allen

Analyst, Morgan Stanley & Co. LLC

Q

Thanks. Good morning. So, a strategic question. You talked in your prepared remarks about starting to open franchising for Hilton Garden Inn in China. I know that was an interesting change because, with Hampton Inn, you did a master franchise agreement. Can you just talk about the rationale? Thank you.

Christopher J. Nassetta

President, Chief Executive Officer & Director, Hilton Worldwide Holdings, Inc.

A

Yeah. It's very straightforward. We've done two. The one you mentioned with Plateno, with Hampton Inn. And then more recently, I mentioned in my comments, we just actually opened our first Home2 Suites by Hilton in China on the road to doing a 1,000 of them with Country Garden, one of the largest players in China, which is another master license agreement. So, we've done those two.

Never say never. I'm not saying we wouldn't. But the idea was to really help – get help from very large local players that knew how to garner scale very quickly to help build our network effect in China and then, ultimately, come back in with our other brands and do it ourselves. And so that's exactly what we're doing with Hilton Garden Inn.

We obviously have a massive franchise system here in the United States, and frankly in Europe now, where the bulk of the business here is franchised. Increasingly, I think, we're now – the majority of the business in Europe is franchised. It's been a much smaller part of the business in China and in Asia Pacific, so we historically haven't had the same level of resources.

And so, what we've done during COVID is made some strategic investments to build out more infrastructure so that we can take other brands of our 18 family of brands and do it ourselves. And so, we're trying to be very sort of balanced and balance all the risks associated with our expansion around the world. And we think it's great to work with third-parties.

We love the Country Garden folks and Plateno. They've been incredibly important partners; will continue to be for a long, long time. But it's also important that we have that skill set ourselves. And franchising isn't – while it's similar in China it's not exactly the same. And so, we've learned a lot and I think built a – we're building a good infrastructure and a good muscle set to be able to take a bunch of other brands and do just what we've done here in the US, Europe and other places.

Thomas G. Allen

Analyst, Morgan Stanley & Co. LLC

Q

And sorry, just as a follow-up to this question. Any updated thinking on potential TAM for these select service brands in China?

Christopher J. Nassetta

President, Chief Executive Officer & Director, Hilton Worldwide Holdings, Inc.

A

I didn't hear the question.

Thomas G. Allen

Analyst, Morgan Stanley & Co. LLC

Q

How many of these hotels do you think you can open in China? What's the addressable market?

Christopher J. Nassetta

President, Chief Executive Officer & Director, Hilton Worldwide Holdings, Inc.

A

Oh, TAM. Okay, you're going tech on me. I love that. I love that. We do look at TAM. I mean, I'm not going to give you that. It's thousands, right? Think of it in the following way. We have limited service hotels in the US, probably 4,500. We have a population of 320 million people. You have 1.3 billion people there. So, there's no limit in my lifetime at least, probably not – you're younger than me, but I'm not that old. So, probably not in your lifetime either.

Thousands and thousands. You could easily have 10,000 or 20,000 or more. So, I think there's growth opportunities in the mid-market as far as the eye can see in China. So, our – while we have done some TAM work in China every time we come back and look at the numbers, they're just – they're off the charts. There are no rational limitations given what our footprint is, what the population is and the growth in their middle class.

Thomas G. Allen

Analyst, Morgan Stanley & Co. LLC

Helpful. Thank you.

Christopher J. Nassetta

President, Chief Executive Officer & Director, Hilton Worldwide Holdings, Inc.

Yeah.

Operator: The next question will be from Smedes Rose from Citi. Please go ahead.

Smedes Rose

Analyst, Citigroup Global Markets, Inc.

Hi. Thanks. Chris, I was just wondering if you could talk a little bit about what your owners are telling you about labor cost in the US and kind of how they're handling re-staffing, and maybe just the sort of idea of [ph] slimmed down (35:56) operating models versus trying to get back to that [indiscernible] (36:01).

Christopher J. Nassetta

President, Chief Executive Officer & Director, Hilton Worldwide Holdings, Inc.

Yeah. Smedes, I had a hard time hearing some of that, but I think, I can try to – the labor costs and what owners are telling us. It's obviously been a big issue and one that we spend a lot of time on, it's a complex issue in terms of what's sort of underneath the problem.

What I would say is, obviously, there is no one owner group. The different owners in different parts of the country and the world, for that matter, have different views. But if I sort of homogenize it all, which is hard to do, but if I do it in my head, I would say, while it's still a very difficult issue, we've started to see easing in terms of access to labor.

I think we have ways to go. There are a bunch of things we're doing to help from a technology point of view to access pools of labor that maybe we hadn't accessed historically. But broadly, more labor is coming back in. And some of those pressures are easing.

Obviously, labor is more expensive, pretty much everywhere. I think that is – that's a reality. Where it settles out, I think it's a little early to know. But I think, it is sort of settling down as people are gradually coming back into the workforce.

I think the end of the question, which is a really important one, which I sort of touched on earlier in one of my other filibusters, was how is it going to look for owners on the other side? And again, it's hard – some owners – it depends on location, product, a thousand factors. But broadly – and we're already seeing it. I think, I said this.

Broadly, I think when we get to the other side of this, across the system, margins are going to be higher and you know why. With input costs going up, labor costs going up and all of those fun things, they're going to be – margins are going to be higher, because rate is going to be a lot higher.

Ultimately, when we get past this for all the reasons, I talked about in terms of the pricing power that we have and the broader inflationary environment. That's very helpful to the business. At the same time, particularly in the mega categories, which is where the bulk of the hotels are with our ownership community, we did a bunch of really important work and did a lot of testing and learning and made a bunch of changes in the hotels, in the end, we think, to create a better experience for our customers, but to do it in a more efficient way to drive higher margins.

So, we're pretty confident. And we have pretty good evidence, which I'll talk about that, even with the – when labor comes back and you have to pay labor more, given where rate structures are going to be in most places and given the efficiencies that we've been able to garner, that these are – our owners are going to end up with higher margin businesses.

And by the way, many, many of them, not all of them, so for those that haven't gotten there that are listening, keep the faith. But many, many owners are already there. Some of it is unsustainable, meaning part of it is they can't get enough labor, and so they don't have enough people so their labor costs are unusually low.

But even in places where they are able to get the labor back for the reasons I described, meaning more efficiencies on our standards and pricing power on the top line, they're driving very good margins. And so, we've had – the owners are – have been in pain. I don't want to minimize it. There's still many of them in a lot of pain. But we're doing our level best to get them to the other side and make sure their businesses are stronger, both because that's what we should do as a fiduciary to them. But also, ultimately, if we want to continue to be able to grow, we have to give them an investment alternative that continues to make sense from a return point of view.

And so, we're hyper focused on it and I would say, I feel really good. As I said, I think the development cycle will flip faster than we've seen in prior cycles for these reasons. I just think that the economics – that the laws of economics are alive and well. I said it now twice or three times, that if people can get great returns because of the conditions, macro and micro, macro world going on micro, the things we're doing, then they're going to want to build us more hotels. And, obviously, with the signings being up in the mid – double – mid-teens to plus, we think that's pretty good prima facie evidence that that's what's going on.

Smedes Rose

Analyst, Citigroup Global Markets, Inc.

Q

Great. Thank you. Appreciate it.

Christopher J. Nassetta

President, Chief Executive Officer & Director, Hilton Worldwide Holdings, Inc.

A

Yep.

Operator: And the next question will be from Stephen Grambling with Goldman Sachs. Please go ahead.

Stephen Grambling

Analyst, Goldman Sachs & Co. LLC

Q

Thanks. This is a bit of a multiparter. But you mentioned that the majority of the pipeline is outside the US. Can you just remind us of what that split maybe looks like within some of the major markets? How the contribution from international room growth could compare and contrast to the US as we translate NUG to fees?

And then if you could just talk to any, kind of, incremental signing opportunities that you're seeing that surfaced in new markets as a result of the pandemic that could be longer lasting? Thanks.

Kevin J. Jacobs

Chief Financial Officer & President, Global Development, Hilton Worldwide Holdings, Inc.

A

Yeah, Stephen. It's Kevin. I'll sort of try to take those in order. I think that the mix of rooms under construction is just over – kind of between 60% and 65% outside the US versus inside the US. I think in terms of – look, we're always trying to enter new markets. I think we have 20-something, 25 to 30 new countries embedded in the pipeline that we don't have today, right? So we're always trying to enter new markets. I'm not sure really anything of that – any of that has been opened up by the pandemic. I think it's just sort of the course of the growth of our business over time.

And then trajectory really has a lot to do with how places are coming out of the pandemic. Meaning we've been – even though there's been spikes up and down in RevPAR in China, for instance, as they go into lockdowns, the development trajectory there has actually continued to be pretty solid and continued to improve. But in places like Europe where, traditionally, it's more of a face-to-face development environment, the less people have been able – the less our teams and the owners have been able to get on planes and move around country-to-country, those signings have lagged a little bit.

So I actually see that as a tailwind coming out of the pandemic, whereas, there's a lot of pent-up demand for development in EMEA broadly. And I think that it's just going to require a little bit more mobility to surface that. But the rest of it is just, over time, as Chris has talked about this, as you have a rapidly developing middle class, with more demand for mid-market products, you're going to see a little bit more of that demand over time. I mean the full service business is not dead by any means. But you're just going to see on the margin, the capital flows more to the limited service hotels.

So we're going to do more deals where the capital flows. And then as we bring franchising, which has been very successful for us, Chris went through it so I won't go through it again, but as we bring franchising to different parts of the world, particularly Asia Pacific, we're just going to do more franchise deals over time. You're not going to see, I don't think big step changes. You're just going to see a gradual growth over time in more limited service mix and more franchise mix. Did that cover all the parts?

Stephen Grambling

Analyst, Goldman Sachs & Co. LLC

Q

One very quick follow-up. So from a net unit growth standpoint then, I guess, the fees that you're getting from the international market may be ends up being a little bit lower because of the RevPAR. But on the flip side, it sounds like you're doing more direct, so there's a potential for that to actually improve within that mix. Is that fair?

Kevin J. Jacobs

Chief Financial Officer & President, Global Development, Hilton Worldwide Holdings, Inc.

A

Yeah. Mathematically, right, the lower price points, it will blend in over time. Again, it will not change dramatically. We've modeled it every which way. And it's really hard to make that fee per room number move. But mathematically, it has to move over time. And the reality is, look, it's very high margin. It's 100% margin. Once we have scale in these parts of the world, it's a 100% margin and infinite yielded. And so, we'll take it.

Stephen Grambling

Analyst, Goldman Sachs & Co. LLC

Q

Awesome. Thank you so much.

Kevin J. Jacobs

Chief Financial Officer & President, Global Development, Hilton Worldwide Holdings, Inc.

Sure.

Operator: The next question will be from Robin Farley with UBS. Please go ahead.

Robin M. Farley

Analyst, UBS Securities LLC

Great. Thanks. A lot of my questions have been asked already. One, just to circle back, and I hope I didn't miss this in the opening comment. I – the operator pulled me out of the call for a minute. But when you talked about group and the expectation that there'll be a lot of pent-up volume for 2022. Can you give us a sense of where – and I think that is a reasonable expectation?

But kind of where the group on the books for next year is versus 2019? Like in other words, it's likely to be higher, or maybe not in Q1, but kind of how that's pacing with what you have on the books for group for 2022. And I don't know if you have it by quarter or first half, second half.

Christopher J. Nassetta

President, Chief Executive Officer & Director, Hilton Worldwide Holdings, Inc.

Yeah. I mean it would be weighted to Qs 2 through 4, first of all, for the reasons I covered in a prior answer. Just meaning people want to get through the winter one, two, the first quarter is never a big group quarter. So you put those two things together, and it trends heavily to Qs 2, 3 and 4. We're in the 75%, 80% on the books which is about consistent with where we were in the last quarter.

And what happened is, I think if you hadn't had the Delta variant spike, we'd probably be somewhat further along. But you had the Delta variant sort of slow – they cooled off the advanced bookings on the group side, which have now picked back up. The other thing going on, of course, is we want to – we do believe there's going to be a lot of group potential, particularly in Qs 2, 3 and 4. And we don't want to commit. There's a level of lack of desire on our part to commit too much space when we know that there'll be a lot of pricing power. So it's sort of a bit of a delicate balancing act.

Robin M. Farley

Analyst, UBS Securities LLC

Okay. Great. Thank you.

Operator: And the next question will be from Richard Clarke from Bernstein. Please go ahead.

Richard J. Clarke

Analyst, AB Bernstein

Thanks. Good morning. Thanks for taking my question. I just noticed on your cost reimbursement revenue has exceeded your – the cost reimbursement expense for the first time really since the pandemic began. And you've lost obviously – non-underlying, but you've lost about sort of \$500 million through that Delta as the pandemic has gone on. Is this the beginning potentially of you being able to claw that back? And could this be a sort of boost to cash flow over the next few quarters?

Kevin J. Jacobs*Chief Financial Officer & President, Global Development, Hilton Worldwide Holdings, Inc.*

A

Yeah, Richard. It's – I wouldn't necessarily describe it as a clawback. I think what happened early in the pandemic is you had sort of – rough numbers, you had revenue go down kind of 85% to 90% overnight. And we did a really good job of taking expenses down, but we can only take expenses down, call it, 60% or 65%. So, we basically were funding from our balance sheet all the commercial engines, and the websites and all the funded part of the business. And so those things really are giant co-ops. They're going to break even over time.

So now what you're seeing is revenues – and by the way, all the fees, all the sources of funds for those programs are funded as a percentage of revenue. So as revenue is climbing, our receipts are going up, and we will ultimately bring those funds back to breakeven, and we will recover those deficits. And at the moment, you're seeing it as surpluses. But I wouldn't necessarily think of it as clawbacks. Those funds run surpluses and deficits from time-to-time. So, I think you'll see it run a surplus for a little while. And yes, the cash is co-mingled. But it's our owner's money at the end of the day and we spend it all on them.

Richard J. Clarke*Analyst, AB Bernstein*

Q

Okay, that makes sense. Thanks.

Operator: The next question will be from Bill Crow from Raymond James. Please go ahead.

William A. Crow*Analyst, Raymond James & Associates, Inc.*

Q

Good morning.

Christopher J. Nassetta*President, Chief Executive Officer & Director, Hilton Worldwide Holdings, Inc.*

A

Good morning, Bill.

William A. Crow*Analyst, Raymond James & Associates, Inc.*

Q

Chris, hey, I hope you don't mind. I'm going to challenge you a little bit on the leisure outlook for 2022. And I'm just wondering how much risk there really is when we think about the combination of the return to office, the absence of government checks, much higher costs from inflation for the consumer and probably pretty considerable pent-up outbound international demand. So, I'm thinking about your comments on rate and leisure and week day leisure in particular. Are we at risk of kind of setting ourselves up for disappointment next year?

Christopher J. Nassetta*President, Chief Executive Officer & Director, Hilton Worldwide Holdings, Inc.*

A

I don't think so. You heard my view. So, you can – we can have a debate about it, but I don't think so, for the following reason. I think the midweek is already being bled out now. So, I don't – I think most people – most kids are back in school. It's in truncates, mobility, even if people aren't in the office, so while more offices are going to open through the rest of this year and into next year.

What we've seen in the pattern of leisure during the midweek, it's our – we've sort of washed out a large part of that already. I may be wrong, but I believe the weekends are going to remain strong, simply because I still think, if

you look at the \$3 trillion of incremental savings during COVID, there's a long way to go to spend it all. And I think people still want to do – they want the experiences that they were starved for. And now it gets concentrated more on weekends, which is what we're seeing now. I believe that will continue.

I don't – so the net of it is, my view, just to be clear, is that relative to a normalized like 2019 level of leisure demand, I think we're getting back more towards that with a little bit better because I think the weekends are going to be a little bit better. I'm not – I agree with you. I don't think that the mid-week leisure is going to be raging. And that's not sort of built into my expectations.

In terms of outbound, yeah, the world is opening up. But then there's inbound too, particularly for the cities that – the big cities, top 25 markets that historically depend on 20% of their business from inbound international travel, they've had zero. And starting next week or week after, the floodgates are going to open on that. So, yeah, you're going to have some people going outbound, but you're going to have a lot of people that want to come see America that is going to offset that. And particularly, with the top 25 markets, broadly, but particularly the top 25 markets that are going to come in.

Again, we're still in the middle of budgets. And we're still debating all of this and where it ends up. I'm giving you my opinion and my sense of it. I think leisure will remain – when we wake up next year and the following year and you compare it to the amount of leisure business that we did, which was probably 25% or 30% of our overall segmentation pre-COVID, I think it will be higher than that. And I think it will be higher than that because people want to get out more. There's plenty of incremental savings in the world that has not gotten anywhere close to being spent. And the weekend business, while we were doing better on weekends than we had historically, I think it will stay even more elevated than that.

William A. Crow

Analyst, Raymond James & Associates, Inc.

Q

Great. And Chris, can I give you the opportunity to maybe update us on the timing for potential capital returns and buybacks?

Christopher J. Nassetta

President, Chief Executive Officer & Director, Hilton Worldwide Holdings, Inc.

A

Yeah. We don't have anything new. But to repeat what I said last time, we are very interested in getting back to returning capital. We firmly believed in our capital allocation strategy pre-COVID, which was, we were producing a lot of free cash flow that we didn't – we can continue to grow the business in an industry-leading way without the use of much of it. And we wanted, as a result, to give it back to our shareholders because there was no reason for us to hoard it or do dumb things with it. And disciplined capital allocation, we believe, is a hallmark of long term, delivering great returns for shareholders.

Our – my belief hasn't been changed through COVID. The only thing that changed is we didn't have a lot of free cash flow during the heat of the crisis. We are obviously getting past that. We are cash flow positive. We want to just give it a little bit more time, as I said on the last call, sort of finish out the year. And if things go as we expect and consistent with what we have been seeing, we're going to reinstate a return of capital program in the first half of next year.

And my guess is it will look quite similar. I mean, we're still having that discussion with our board, who obviously has say in it, but I think if I had to pick a line, I think it will look a lot like what we were doing pre-COVID. And we're very focused on it and very anxious to get back to it. And so I direct you – I would say first half of next year.

William A. Crow

Analyst, Raymond James & Associates, Inc.

Perfect. Thank you.

Q

Christopher J. Nassetta

President, Chief Executive Officer & Director, Hilton Worldwide Holdings, Inc.

Yeah.

A

Operator: The next question will be from Patrick Scholes with Truist Securities. Please go ahead.

Patrick Scholes

Analyst, Truist Securities, Inc.

Hi. Good morning.

Q

Christopher J. Nassetta

President, Chief Executive Officer & Director, Hilton Worldwide Holdings, Inc.

Good morning.

A

Patrick Scholes

Analyst, Truist Securities, Inc.

A question on labor cost, and specifically Hilton Corporation's labor costs. Any change in your expectations for G&A and trajectory of your G&A versus what you said in the past? And correct me if I'm wrong, I have in my notes here, you talked about sensitivity of EBITDA to RevPAR, EBITDA growth about 1.3 times RevPAR growth. Is that still your thoughts on that trajectory?

Q

Kevin J. Jacobs

Chief Financial Officer & President, Global Development, Hilton Worldwide Holdings, Inc.

Yeah. I think what we said, Patrick, is that in the context of when RevPAR levels are elevated, the RevPAR growth is elevated the way it is. It will be in that zone. I think it should be, obviously, 90% of the business is from fees that should be about one-to-one as things normalize. We think we can do a little bit better with net unit growth, cost discipline, license fees, things like that. Maybe a little bit better than one-to-one over time. But I think the 1.3 times is more of when RevPAR is elevated.

A

And then no change – short answer is no change in our views on G&A, right? We've been very disciplined. I think what we've said to you guys is that cash G&A ought to be down this year in the mid-to-high teens from 2019 levels. We actually might do a little bit better than that this year because we've had pretty good cost discipline.

GAAP is different, but you got a lot of moving pieces. Particularly in the third quarter this year, we're lapping over some of the write-downs of stock comp from last year.

And then going forward, again, no real change. I think we all understand that, with more business activity, it's going to come a little bit more expense. And just like we're in an inflationary environment that's going to help on the revenue side, we're going to be paying people a little bit more along the way. But we do think we're going to maintain discipline. The changes that we've made to our structure are going to hold going forward. And we feel – still feel the same way.

Patrick Scholes*Analyst, Truist Securities, Inc.*

Okay. Thank you Kevin.

Q

Kevin J. Jacobs*Chief Financial Officer & President, Global Development, Hilton Worldwide Holdings, Inc.*

Sure.

A

Operator: The next question will be from Vincent Ciepiel with Cleveland Research Company. Please go ahead.

Vince Ciepiel*Analyst, Cleveland Research Co. LLC*

Great. Thanks. Question on distribution. You guys have done a nice job driving direct business with, I think, loyalty contribution, around 60% pre-COVID. I know OTA contribution fell from high-teens to about low doubles while reducing commissions along that path, so a lot of exciting things happening on the distribution front. I'm curious, on the other side of this, how you're thinking about OTA contribution as well as how high that loyalty contribution can get?

Q

Christopher J. Nassetta*President, Chief Executive Officer & Director, Hilton Worldwide Holdings, Inc.*

Yeah, really good question. I don't feel really a lot different than I did pre-COVID. I mean, we believe there's an efficient frontier. And we've calculated it as best we can by individual market property, what – based on what they can deliver at that price point versus what we can deliver, how do we deliver the highest index, the highest revenue for the lowest distribution cost.

A

And we do believe, and that's why we've had a good relationship with the OTAs, that they play a part in that. It's traditionally been in the sort of 10% or 12% range, and that's historically where we've been.

During COVID, that went up. But if we wanted it to go up, we partnered, I think, quite successfully with our OTA partners knowing that the biggest segment of demand that was out there for most of COVID was lower rated leisure, which is what they are particularly good at, non-loyalty – non-loyal type customer base. And so it crept up a bit, but not too terribly much. And we've already seen that sort of peak and start to come down. And so while we'll look at the efficient frontier as we always do periodically, and maybe if you think leisure is going to be a little bit higher component overall, maybe it goes up a little but not much, and it didn't move that much.

So the net of all that is, I think when we wake up in a couple of years, it will look an awful lot like it did before. And we, obviously, feel good about the contractual terms that we have with the OTAs now and our ability to continue to have attractive terms going forward.

As it relates to Honors, the My Honors team is probably listening, and they may need a diaper for this. But we're – we maxed out in the 63%, 64% system-wide. And we're already in the US, as I mentioned in my prepared comments, not that far off of that. Globally, we're coming back as our more of – number one, we've accessed more travelers that weren't loyal. So some of these leisure travelers that we didn't have access to, we've now access. And more of our core customer is getting back on the road. We're getting back to normal.

I'm not going to put a number out there because I'll give a heart – my team will have a heart attack. But I believe that there is a lot of room to grow. I think the super majority – if we're doing our job, the super majority of our customers want to be Honors members.

It's a proposition that they get benefits that you just don't get, and they're meaningful. And you can go through them, they get discounts, they get technology, they get experiences money can't buy. They get points that are a currency. They can shop on Amazon and Lyft and buy tickets at Live Nation.

And there is no reason as we continue coming out of this to actively engage with our customer base. Where it shouldn't be – we shouldn't be able to push it meaningfully higher than where we kept – where we maxed out before.

Now that will take time. And so, to my Honors team, don't freak out. We're going to give you the time. But our goal is there, which I'm not going to state publicly, are meaningfully higher than where we were, which, by the way, is meaningfully higher than any of our competitors already.

Vince Ciepriel

Analyst, Cleveland Research Co. LLC

Q

Thanks.

Operator: Ladies and gentlemen, this concludes our question-and-answer session. I would like to turn the call back to Chris Nassetta for any additional or closing remarks.

Christopher J. Nassetta

President, Chief Executive Officer & Director, Hilton Worldwide Holdings, Inc.

Thanks, everybody, for the time today. I know it's a busy earnings season. We're obviously quite pleased, given what we've all lived through over the last 20 months, to be able to report the progress that we were able to report for the third quarter. As you could tell from the call, I remain quite optimistic about where this recovery is going and what the opportunities are in the industry, but particularly for our business and the growth of our business.

And we'll look forward to reporting fourth quarter and full year after the New Year. We look forward to seeing many of you while we're out on the road. And have a terrific day and holiday, if I don't see you.

Operator: And thank you, sir. The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.

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