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SWK.N - Stanley Black & Decker Inc at Robert W Baird Global Industrial Conference

EVENT DATE/TIME: NOVEMBER 09, 2022 / 2:30PM GMT

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PRESENTATION

Timothy Ronald Wojs - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

So good morning, everybody. I'm Tim Wojs. I cover building products here at Baird, and we're happy to have Stanley Black & Decker join us again this year at our Global Industrial Conference. Stanley is the world's largest tool company, and they own several leading brands, including DEWALT, CRAFTSMAN, STANLEY FATMAX, BLACK+DECKER and LENOX, among others.

So from the company, we have CEO, Don Allan; we have Dennis Lange, who's VP of IR; and then we have Christina Francis, who's somewhere in the audience. So we're going to start with, I think, about 10 minutes of prepared remarks with Don, and then we'll go into Q&A. So with that, the floor is yours, Don.

Donald Allan - *Stanley Black & Decker, Inc. - President, CEO & Director*

Great. Thank you, Tim. Good morning, everyone. I'd like to start with just a bit of a refresher that we've gone through a lot of different portfolio actions as a company in the last 12 months or so where we become a much more streamlined company but still with some great franchises.

And obviously, the biggest one is our Tools & Outdoor business, which is made up of -- almost half of that business is power tools. A quarter of it is outdoor power equipment, which includes handheld equipment as well as large landscaping products as well and mowers. And then, of course, we have our hand tools, storage and accessories business, which makes up the remainder, which is about 25% as well.

Revenue last year was approaching just over \$15 billion. You can see the pro forma number there when you factor in some portfolio moves. The acquisitions in the outdoor space of MTD and Excel closed in the fourth quarter of last year, and so we have a full year effect of that in 2022.

The brands that we have in the businesses are just outstanding. And so we have brands such as DEWALT, STANLEY, CRAFTSMAN; and then the next tier down, consumer brands like BLACK+DECKER; specialty brands such as IRWIN and LENOX; and then in the outdoor space with MTD and Excel came fantastic brands in CUB CADET and HUSTLER, which came from the Excel acquisition.

We are the world -- as Tim mentioned, we are the worldwide leader in Tools & Outdoor, and we plan on continuing to be the #1 player in this space as we think about the next decade going forward as a company. We also do have an Industrial business, which makes up about \$2.5 billion in revenue on an annual basis.

It's primarily an Engineered Fastening business, which is really a highly technical specialized fastening business that serves 2 major industries in both automotive manufacturing and aerospace, but also has a fairly sizable general industrial manufacturing business that it serves as well. And these are really fasteners that are tailored to the product being manufactured that helps the OEM be more efficient in the manufacturing process and really prove productivity with each model that rolls out, whether that's a car or a new version of a plane.

The company has been known and will continue to be known for a company that has great brands, as I mentioned. that's had a long track record of powerful innovation, and we will continue to do that going forward. We believe we have the broadest category and channel coverage across our Tools & Outdoor businesses in particular.

And we've had a strong operating model that we need to leverage as we go through a very significant transformation as a company as we have been impacted in a very negative way by some of the really challenging supply chain events and constraints and things that occurred over the last couple of years that affected a lot of industries, but certainly did affect our industry in a big way.

We're powered by our people, and we're guided by our purpose, and the purpose is for those who make the world. So where are we today? We announced back in June time frame that we were putting together a framework of how to transform Stanley Black & Decker to make it an even more streamlined company, a more efficient company, but also find ways to invest in certain key areas of the company that I'll touch on in a few minutes that need additional investments for us to continue to be successful in what we've done for so many years.

So the first step was to look at where do we become more efficient in our SG&A? And you can see we looked at simplifying corporate and investment prioritization, took about \$200 million of costs on an annualized basis out that has been completed over the summer into the early fall. We created a new organization structure that really flattened the organization and increased the spans of control, and that was about \$100 million of annualized benefit. That has been completed as well.

And then the third area is continued strong focus on indirect spend. Initial savings that contributed in a significant way to our Q3 results, and we're building a funnel of an annualized basis of \$200 million that we expect to achieve at some point next year. Overall, that's \$500 million in annualized benefit that ultimately will help us fund some key investments that we need to make in innovation, user activation, digital marketing and a few other areas.

We also need to radically accelerate the transformation of our supply chain. For those of you who have followed us over the last decade or so, we have had a rather methodical approach of continuing to move our supply chain closer to our customer base. We need to accelerate that. The pandemic demonstrated, with a long supply chain, how challenging that can be, and it requires you to maintain high levels of inventory.

So what are we going to do? We're going to focus on SKU reduction and product platforming, which will simplify the product offering that we have and reduce some significant complexity within our business; get even more aggressive around strategic sourcing and really activate some quick wins here in the short term, but make this a world-class process that continues on in Stanley Black & Decker for the foreseeable future.

Facility consolidation. This one, to me, is more of just a continuation of the integration of many of the acquisitions that we did. When we acquired several companies in Tools & Outdoor, we achieved a lot of synergies related to back-office synergies, front-end revenue synergies, organizational synergies in general, procurement synergies, but we didn't aggressively go after the footprint.

And so we're going to do that as part of this transformation over the next 3 years. And then getting back to some things that we've had in our past around operations excellence, really making sure that each plant and each DC is the most effective and efficient location or plant or DC that we have in our system.

The transformation is well underway. You can see on the left side we've achieved the vast majority of that. The right side, we're in the early stages or phase 1 of it, but we think there's \$1.5 billion of value that we can achieve over a 3-year time frame by 2025, which will ensure that we get our gross margins back to 35-plus percent.

So we are really transforming this company so we can accelerate organic growth. We've done amazing acquisitions, as I mentioned a few minutes ago, that have built a wonderful Tools & Outdoor business that is #1 in the world. We need to optimize that. We need to reduce the complexity, and we need to be very focused on what our priorities are, and we need to transform our supply chain.

That will allow us to invest \$300 million to \$500 million over the next 3 years in the 4 different categories you see here: innovation; electrification, in particular, in the outdoor space as we continue to drive new product solutions and innovations in that particular category, because that category is moving fast from single gas engines to battery-operated solutions; maintaining our market leadership in all the key categories that we play in, power tools, hand tools and outdoor equipment; and then make sure that our supply chain, continue to invest in that, is as responsive as it could be given the volatility that we see in the world today.

We believe the end result will be enhanced shareholder value, which will allow us to drive organic revenue performance, which would be 2 to 3x whatever the market growth is. I mentioned the 35%-plus gross margin by 2025; get back to strong free cash flow on an annualized basis of 100-plus percent conversion to net income; continue the powerful innovation machine and make it even stronger; and then make sure that our customers are delighted every day, every week, every month, every quarter.

We all have a clear vision and a new strategy for our long-term success going forward. We're a company that's been around for over 180 years. This is another phase of the evolution of Stanley Black & Decker. We are a more focused company, a more purpose-driven company that ultimately will continue to deliver strong shareholder value over the long term.

With that, I'm going to turn it back to you, Tim.

QUESTIONS AND ANSWERS

Timothy Ronald Wojs - Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst

Great. If anybody has any questions, you can e-mail session2@rwbaird.com. Maybe just to start, Don, just maybe kind of some background or kind of some kind of level setting us on the supply chain.

A lot of moving parts with battery cells and then electronics and transportation and those types of things, but I guess where are you on a lot of -- securing a lot of these kind of structural things around chips and lithium and motors and those types of things so that issues don't kind of, I guess, creep up again? And I guess is there still kind of things you need to do to kind of get those components in the right spot?

Donald Allan - Stanley Black & Decker, Inc. - President, CEO & Director

Yes. Good question. So there's really 2 key areas for Stanley Black & Decker that could become challenges, and have -- we have had some challenges in some of those areas over the last 12 to 15 months. They're battery cells, they are semiconductors, and then there are certain commodities that occasionally were challenged.

On the commodity side, we feel very good about where we are, in position. We're not having any supply constraints related to any specific commodities such as steel or resin or whatever the case may be. The battery cell component was a little bit challenging in the first half of '21, so a while ago, but we got ourselves into a good place for the key battery cell providers, and that has not been a supply constraint for us in the last 1.5 years, roughly 1.5 years or so.

Semiconductors was really the area that has been a big challenge for us that in the third quarter of this year, we finally got to the point where we were getting enough semiconductors to meet the demand in the marketplace. And really where that hurt us the most was our DEWALT power drills. And so the high-end premium power tools that a pro construction worker uses, we just were not getting enough of these, what I would call, premium semiconductors.

Getting enough in certain areas like CRAFTSMAN power tools, Stanley Black -- BLACK+DECKER power tools, but not enough in the DEWALT space. That has shifted in Q3, and it allowed us to make sure that we met the holiday season promotional calendar with our big customers like Home Depot and Lowe's and several others, including Ace, that we were not able to do for the last 1.5 years, in particular related to DEWALT.

So the DEWALT business for the last 1.5 years has really just been we make what we can based on the supply we had. We sold it to our customers, and it was basically doing its best to meet the core demand, but it wasn't really able to meet the need around promotional calendar. And in the case of our business, there's 2 key areas of promotions that happen each year. There's the Father's Day season, which is May, June, kind of Memorial Day through Father's Day, and then there's the holiday season that's happening now through the end of this year.

And we've been able to meet the need of this holiday season. We shipped a significant amount of product for the promotional activities. And really, what that is, is products that sit at the end cap of an aisle versus in the aisle or in the tool crib, and then they have these kind of pro off-shelf areas where they stack up different types of products, and they put a lot of the promo items in there as well. So we have been able to meet that need here in this holiday season.

We're already talking about the demand for the upcoming Father's Day season, which may seem like a long way off. But when you're dealing with these larger customers, you're actually having those conversations right now. So the good news is we feel like our supply is back to where it needs to be, and we're meeting the existing demand in the market.

Timothy Ronald Wojs - Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst

And I guess from a shelf space perspective or share perspective, I mean, do you feel like you're -- you've at least been able to kind of maintain share through a lot of this? Or is it really just as you get your service levels back to the levels you want to get them and your on-shelf back to the levels you want to get them, do you see kind of POS kind of suggesting that you're maintaining or kind of gaining share within the category?

Donald Allan - Stanley Black & Decker, Inc. - President, CEO & Director

Yes. I think when you look at the different categories of power tools, hand tools and outdoor, in hand tools and outdoor, I think we've continued to gain share over the last year, 1.5 years or more. Power tools for DEWALT was challenging, and so we went through a period of time where we probably lost a point or so of share, and that's just the reality of being constrained on the supply side.

The good news is I feel like what we're doing now is we are going to be able to, at a minimum, maintain share going forward, but more importantly, we're going to be able to gain share because of how we've addressed the supply constraint issues, but also because we're going to invest more in the innovation side.

Timothy Ronald Wojs - Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst

Okay. A question here from the audience. So on the inventory side, was the build in inventories driven by the idea that you thought demand would last longer than it did? Or was it kind of overcompensating for a lot of the supply chain and trying to make sure you have the safety stock on the balance sheet?

Donald Allan - Stanley Black & Decker, Inc. - President, CEO & Director

Yes. I would say 75% was an expectation that demand would continue to be at very high levels for multiple years. There was another component that is what you described, which is just building higher levels of safety stock in certain categories. But I would say we probably have an extra level of inventory of about \$1.5 billion now, and that's something that we're very much focused on of reducing over the next 15 to 18 months.

We actually think it can help us drive a fairly significant cash flow performance in that time horizon. We made good progress in the third quarter. We reduced inventory for the first time in quite a while by about \$300 million. We expect that we'll see another reasonable level of reduction here in Q4 in inventory and then probably close to \$1 billion of a reduction in inventory in 2023.

Right now, that's really our top focus because we have too much inventory in certain categories. And then in other categories, we'd like to build a little bit more of safety stock like our DEWALT product (inaudible). And so we're focused on that as our first priority, which means that -- earnings are a second priority for us right now.

It's not like we're giving up on earnings, but we are having to make decisions that are pulling back production in our manufacturing plants that allow us to bring these inventory levels down that will have a punitive impact and have had a punitive impact in Q3, will have more of a punitive

impact in Q4, Q1 and part of Q2 of next year, probably. That's just the reality of where we are. We think that's the prudent decision as a company to make sure that we don't maintain excess levels of inventory.

And two, we think it positions us for whatever recession we're going to go through. For us, we kind of -- we've been in a recession. So we've had a consumer recession that we've been dealing with. There's probably some type of professional construction worker recession coming as housing slows due to rising interest rates and maybe unemployment rising. We'll see what happens over the coming months and quarters.

So we think we're well prepared to manage and navigate through that, but the impact will be punitive to our P&L until we get through that and we get to a point where our inventories are at the right level and then we can get manufacturing production back up to the right levels of capacity and utilization that you normally want to see.

Timothy Ronald Wojs - Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst

Okay. One of the bigger questions we've got in first quarter is just with the kind of production curtailments and then the work to kind of take inventory off the balance sheet, I mean, where are you kind of producing to? And I guess the question people are asking is, are you kind of including that there's some -- or thinking there's going to be some weakness in the pro? Or is that something that's just to be determined at this point?

Donald Allan - Stanley Black & Decker, Inc. - President, CEO & Director

It's to be determined. I would say the level we're producing at right now, since we do have a decent lead time, so whatever we're making today is really product we're going to be selling in Q1, maybe early Q2. So we're assuming a performance level somewhere between relatively flat to what we're experiencing today to modestly down.

Now as we get closer to the early part of '23, we're going to recalibrate that. We're either going to adjust it down modestly or adjust it up slightly depending on what we see for the remainder of the first half of next year.

One of the things we have going for us on the production side is that we do know we're going to have probably a significant promo season in May and June that we didn't have last year. And so that gives us a little bit of upside flexibility in our production that allows us to maybe produce at a slightly higher level than you would if you didn't have that situation.

Timothy Ronald Wojs - Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst

And that's more from a product availability standpoint than an environmental one.

Donald Allan - Stanley Black & Decker, Inc. - President, CEO & Director

Exactly.

Timothy Ronald Wojs - Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst

And then just from an inventory -- I mean these are products that -- they're not lettuce. They don't necessarily go bad. How do you think about balancing, reducing inventory with just pricing and those kinds of things? Because we've had just questions about if you're doing this and Makita is doing this and et cetera, is there going to be some sort of more intense promotion activity than normal in the power tools space?

Donald Allan - Stanley Black & Decker, Inc. - President, CEO & Director

We're not seeing that yet, but it is something we're looking for, we're monitoring. Like all of you, it's a concern that we have is do competitors start to do irrational things on the promotional pricing side? I don't know if that will be the case. I mean Techtronic likes to have high levels of inventory. So I think they're going to maintain high levels of inventory.

So they have roughly 220 days of inventory today. They'll probably maintain at that level or reasonably close to that level. The key to those have close to 12 months. That's a lot of inventory. If I imagine they'll try to move it and get down to something that is lower than that, but historically, they still have maintained high levels of inventory. And so we're probably -- we're at 180-ish days.

We probably want to get down, over time, closer to 130-ish and maybe eventually to 100. But we think we can do that over a reasonable time frame of probably 15 to 18 months, and it does not require us to do aggressive discounting, either discounting to the channel customers or discounting at the -- in the customers to pull it through at this stage. I mean we obviously -- we'll have to continue to monitor that and watch that.

Timothy Ronald Wojs - Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst

Any questions from the audience in here?

Unidentified Analyst

(inaudible)

Donald Allan - Stanley Black & Decker, Inc. - President, CEO & Director

Yes. I mean if you think about the categories I went through in the presentation, strategic sourcing, which is of that \$1.5 billion is probably about 1/3 of it, is really looking at simplifying our supply base, our vendor base and really leveraging the spend even more effectively than we have historically in the last couple of decades. To me, that's more of working with our vendor base and really being much more efficient in the purchasing activity at lower cost points. That's probably the biggest thing that's outside of Stanley Black & Decker.

The other areas, though, like product platforming, are really -- taking a look at our -- the best example I can give folks is we have 11 different DEWALT drills. They can be 20-volt, 60-volt, FLEXVOLT. They have all kinds of different varieties, too. Then you have ATOMIC. You have XTREME. You have all kinds of variations to it. And they've been designed and innovated in a way that made them unique, for some reason that at the time made a lot of sense.

But what didn't happen was looking at all 11 of them and saying, "What is the common components we can use across all 11 of them?" So the crazy example I can give you is we have some drills that have 7 screws in them that keep them together. We have some drills that have 8 screws that keep them together. We have some drills that keep 4 screws that hold them together, and then the types of screws are all different.

Those are things that you just need to look at and say, "Well, okay, there's common things we want to do across this particular product family. Let's leverage the spend. Let's leverage the design." And then what it does is it helps you not only drive benefit with your external vendor base, because you're leveraging the spend, but what -- it allows you to innovate faster because you're not starting from scratch every single time around.

You're starting with a platform and you say, "Okay, 60% of the product is standardized. The remaining 40% is going to be tailored for something unique that the end user wants that they think is differentiated." That's a combination of what we need to do internally and with our external vendor base. The rest of it is really us, what we do internally, consolidating our plants, refining our logistical distribution network and really driving operational excellence in each manufacturing location.

Timothy Ronald Wojs - Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst

Any other questions? On the \$1.5 billion, I mean, do you feel like you have pretty good visibility or a pretty good road map to attaining those numbers over the next 3 years?

Donald Allan - Stanley Black & Decker, Inc. - President, CEO & Director

\$1.5 billion?

Timothy Ronald Wojs - Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst

Yes.

Donald Allan - Stanley Black & Decker, Inc. - President, CEO & Director

Yes. I would say that we're in the final stage of really nailing down the detailed plan and the feasibility assessment. That will be complete by first week of December. And at this stage, we're pretty much done. So we pretty much -- we've got a few little nits and nats to nail down and say we're ultimately done and we're ready to go.

But I can see visibility in detail that gets us to \$1.4 billion, and then there's another \$100 million we need to go after. And we have a couple of categories where we know we can get that. We just need to spend more time. But there's detailed plans right now that get to \$1.4 billion of the \$1.5 billion.

Timothy Ronald Wojs - Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst

Okay. Good. And then on the -- so you've taken out some of the layers, some of the SG&A around indirect. How fast do you anticipate bringing the investments back into the business? And I guess how will that change kind of going forward maybe versus what Stanley has done over the last 5 or 10 years?

Donald Allan - Stanley Black & Decker, Inc. - President, CEO & Director

Yes. So we've started to invest a little bit this year in electrification because we know that's an important category for innovation, but it's also a category that you can see is moving fast battery-operated products. Next year, we'll probably do an incremental \$100 million to \$150 million of investment in these areas of that \$300 million to \$500 million. So I think for the next 3 years, you can probably count on there being \$100 million to \$150 million each year of additional investment in the areas I went through.

We're not going to wait and see, and we're not going to sit here and say, let's wait and see where the recession goes. We know we have to do these investments. It's an important part of the strategic framework for our success for the next 3 to 5 years. And I think I probably criticized myself by saying this, but if you look at the past, we were a little sporadic in where and when we invested. We decided to hold and pause on things due to trade tariffs, currency challenges. You know the story. All the different things that we've seen.

We need to be more consistent in this area of investment because it is ultimately the dynamic that allows for the type of performance that I laid out of 2 to 3x organic growth versus the market, 35% plus gross margin profitability, et cetera, et cetera. When you play yin and yang with these investments a little bit too much, you make progress, then you fall back. You make progress, then you fall back. And it just -- it's a model that doesn't work in the industries that we serve.

Timothy Ronald Wojs - Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst

And to get to the 2x, 3x market, I mean, is it products? Is it just having more feet on the street to kind of get the growth there? Where are the big buckets? Yes.

Donald Allan - Stanley Black & Decker, Inc. - President, CEO & Director

It's both. I mean I think we're not lagging in a big way on the innovation side. We just -- we want to accelerate and put more fuel into the fire, so to speak. But at the end user activation level, we need more resources. We need more folks out there that are driving a DEWALT truck around or a CRAFTSMAN truck around. They're outside of a Home Depot interacting with end users as they're going in and out, showing them the new products, the new innovations, showing them how DEWALT is better than the competitor product and why it's differentiated and why they should purchase that product.

Or if they're already a big DEWALT user, they're looking at whatever the new cool innovation is coming out at that time. That's where you win the war on share gain. And that's the area that we need to continue to increase our investment. And probably when this is all said and done, you'll probably end up seeing more investment in that area than the innovation area.

Timothy Ronald Wojs - Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst

Okay. Just on the battery systems. You've got 20-volt, you've got FLEXVOLT. Where do you see those migrating over time when you're thinking about run time, you're thinking about cost, power?

Donald Allan - Stanley Black & Decker, Inc. - President, CEO & Director

Well, I mean POWERSTACK -- DEWALT POWERSTACK came out, I don't know, 6 to 9 months ago.

Dennis M. Lange - Stanley Black & Decker, Inc. - VP of IR

In December last year.

Donald Allan - Stanley Black & Decker, Inc. - President, CEO & Director

Yes. Thank you, Dennis. And that's the next evolution of battery technology, which is basically pouch battery technology versus cylinders. And longer run time, quicker charges, I mean, all these things are going to continue to be the evolution of where the battery technology goes. Now the good news is a lot of these things interact with our existing tools. So we have 20-volt batteries. We have POWERSTACK. We have FLEXVOLT batteries that flex between 20-volt and 60-volt. And then we have ATOMIC and XTREME, which have lower battery voltages with them.

So the battery system we continue to build out and the products we continue to build out have a lot of consistency to it. So when you get into the DEWALT family or the CRAFTSMAN family, you can get in there, and the batteries that are DEWALT and the tools that are DEWALT, for the most parts, you're able to interchange a lot of that. And that's incredibly important, from our point of view, where you don't get yourself in this camp of here's a 20-volt family, here's a 60-volt family, here's something in between, and there's not a lot of interchangeability amongst them.

Timothy Ronald Wojs - Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst

Right, right. On MTD, can you just give us a little bit of an update on kind of how the integration is progressing there? And then what you're bringing to the table in terms of electrification to that business?

Donald Allan - Stanley Black & Decker, Inc. - President, CEO & Director

Yes. The integration is going well. I mean the synergies are actually slightly ahead of the goal and the expectation we had in the first years. The -- we were all disappointed with the outdoor season because the weather was so bad in most parts of the United States that the outdoor season was bad across the board.

But that's a seasonal phenomenon, and all the customers and us have already moved on to talking about next season and where that's going to go and planning for that. So we feel very good about the business, but you're going to have some seasonality that you're going to occasionally have to deal with.

What we bring is the technology around battery to that business. And so I think most folks know that there was a period of time where we only own 20% of MTD. We acquired the remaining 80% in the fourth quarter last year. And in that period where we were a 20% owner, we actually built a -- this joint team across the 2 companies that we're working on, the battery electrification innovation technology together, and we were sharing things under kind of a written agreement and confidentiality.

So we've made a lot of progress in the last couple of years as a result, and we've been launching new products because of that team. And now we're putting more investment in that space, as I mentioned a few minutes ago. So we're really excited about where that's going to go. And I think we bring a level of manufacturing expertise as well that we can partner with them to make sure that they become even more efficient in the manufacturing process.

Timothy Ronald Wojs - Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst

Great. We're out of time. So please join me in thanking Don and the Stanley team for being here.

Donald Allan - Stanley Black & Decker, Inc. - President, CEO & Director

Thanks, everybody.

Timothy Ronald Wojs - Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst

The team will be available for breakout.

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