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Core & Main, Inc. (CNM)

Q3 2024 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Hello and welcome to the Core & Main Q3 2024 Earnings Call. My name is Alex. I'll be coordinating the call today. [Operator Instructions] And I'll hand over to your host, Robyn Bradbury to begin. Please go ahead.

Robyn Bradbury

Senior Vice President-Finance & Investor Relations, Core & Main, Inc.

Thank you. Good morning, everyone. This is Robyn Bradbury, Senior Vice President of Finance and Investor Relations for Core & Main. We are happy to have you join us this morning for our fiscal 2024 third quarter earnings call.

I am joined today by Steve LeClair, our Chair and Chief Executive Officer; and Mark Witkowski, our Chief Financial Officer. Steve will lead today's call with a business update and an overview of our recent acquisitions. Mark will then discuss our third quarter financial results and updated fiscal 2024 outlook, followed by a Q&A session. We will conclude the call with Steve's closing remarks.

We issued our earnings press release this morning and posted a presentation to the Investor Relations section of our website. Our press release, presentation and the statements made during this call may include forward-looking statements. These statements are subject to risks and uncertainties that could cause actual results to differ materially from our expectations and projection. Such risks and uncertainties include the factors set forth in our earnings press release and in our filings with the Securities and Exchange Commission.

We will also discuss certain non-GAAP financial measures, which we believe are useful in assessing the operating results of our business. A reconciliation of these measures can be found in our earnings press release and in the appendix of our investor presentation.

Thank you for your interest in Core & Main. I will now turn the call over to Chair and Chief Executive Officer, Steve LeClair.

Stephen O. LeClair

Chief Executive Officer & Chair, Core & Main, Inc.

Thanks, Robyn, good morning, everyone, and thank you for joining us today for our fiscal 2024 third quarter earnings call. Our teams delivered strong performance with record quarterly sales of over \$2 billion and adjusted EBITDA of \$277 million. We have once again shown that Core & Main can grow in any environment. Our ongoing focus on driving organic market share gains, combined with our disciplined approach to M&A, enabled us to achieve nearly 12% sales growth in the third quarter.

We will discuss our results in more detail later in our prepared remarks. But first, I'll begin on page 5 of the presentation with some emerging themes in the water sector. The United States continues to face a growing disparity between water supply and demand, driven by a combination of environmental, demographic and economic factors. Groundwater reserves are being depleted at a rapid pace, especially in agricultural areas reliant on irrigation. Aging water infrastructure compounds the problem as leaks and inefficiencies lead to significant losses in a resource that is becoming increasingly scarce. Together, these factors create a challenging situation for maintaining reliable water supply.

At the same time, demand for water is surging. Population growth is driving higher consumption levels for municipal and domestic use. Economic development, including energy production and expanding industrialization, also requires vast amounts of water. Meanwhile, agriculture, which accounts for approximately 70% of freshwater use in the US, continues to consume large quantities to meet the demands of a growing population. Without significant efforts to improve water conservation and repair and upgrade aging infrastructure, the gap between water supply and demand will continue to widen.

Addressing the widening gap requires bold investments in modernizing and expanding water infrastructure and the Infrastructure Investment and Jobs Act provides a critical opportunity to do so. The Act allocates billions of dollars to improve water systems across the US, funding projects to repair aging pipelines, upgrade treatment facilities, and develop technologies for water reuse and recycling. These investments, which we expect will continue to receive bipartisan support, are crucial for enhancing efficiency and reducing water loss, ensuring that every drop counts in a time of increasing scarcity.

With our extensive product and service portfolio spanning water, wastewater, storm drainage and fire protection systems, Core & Main is well-positioned to play an important role in meeting the growing demand for infrastructure upgrades and supporting the development of resilient future-ready water systems.

Turning now to our end markets in the third quarter. The residential end market was modestly positive and there continues to be significant pent-up demand for new housing in the US. If mortgage rates come down and affordability improves, we expect to see stronger levels of residential construction activity as homebuyers reenter the market, unlocking demand that has been accumulating over the past few years. The non-residential end market remained stable and our backlog and bidding activity continued to grow. This momentum strengthens our confidence in our outlook.

Municipal repair and replacement activity continues to be resilient, and we were pleased to see an increase in new project starts from the second quarter. We are also beginning to see more projects funded by the Infrastructure Investment and Jobs Act, signaling a positive trajectory for investments in municipal water infrastructure in 2025 and beyond.

Each of our end markets benefit from secular growth trends that are expected to continue over the long term. Municipal demand, which represents over 40% of our business, has demonstrated steady growth historically due to the critical need to replace aged water infrastructure. With better access to capital, higher water utility rates and federal funding on the horizon, we expect this market to grow steadily for the foreseeable future.

Residential and non-residential construction activity remained below long-term historical averages when adjusting for population growth. And both end markets are poised to benefit from demographic shifts, population growth, a shortage of buildable lots for new homes, and the need for non-residential infrastructure to support the expansion of suburban and rural communities.

Moving to our operations, our facilities in the Southeast were up and running again shortly after Hurricanes Helene and Milton passed, and they suffered minimal damage. Hurricanes can be disruptive to our operations in the short term, but they can create medium- and long-term tailwinds for our business. In the short term, shipments slow down as products are not able to be brought onto the job sites due to the destruction, flooding and ground saturation. And many of our customers are focused on the recovery efforts.

Over the medium term, we typically see a favorable impact from critical infrastructure repairs. And over the long term, new projects and regulations are designed and constructed to handle higher volumes of storm water. Our

associates in Florida and Carolinas are safe and accounted for, but many had their lives disrupted and we continue to offer support to those who need assistance.

Our product customer geographic expansion initiatives continue to outpace core end market growth, highlighted by the 24% growth we achieved in meter sales during the quarter and supplemented by our execution on water and wastewater treatment plant projects.

Last quarter, we talked about our position as one of the nation's leading providers of advanced metering solutions and the value proposition we bring to our municipal customers. We are also a leading provider of engineered products that are found within water and wastewater treatment plants.

We have historically focused on the connections that bring water and sewer utilities to and from treatment plants and their customers. But these treatment plant projects provide us with a substantial opportunity to expand inside the fence, selling a wider variety of specialty valves and equipment. We have continued to invest in key talent that understands the unique specifications for treatment plants, have the knowledge to navigate the complex funding processes they follow. These investments, coupled with our partnerships with national contractors who specialize in these projects, have been key to our growth.

We also opened new locations in Hayden, Idaho and Chattanooga, Tennessee, during and after the quarter, expanding our geographic reach and allowing us to better serve our waterworks customers in key markets. Each time we add a new location, we add key talent that enhance our value proposition, giving us the opportunity to earn market share. Our team is actively evaluating a pipeline of priority markets to expand into, and we have plans to open more locations over the next several quarters.

We expanded gross margins by 20 basis points sequentially from the second quarter through the success of our initiatives. We have done a tremendous job structurally enhancing gross margins over the years through the addition and expansion of our private label strategy, driving synergies through M&A, and optimizing the way we source and price our products. We have been very transparent about the temporary gross margin tailwinds we have experienced over the past two years, and our expectation for gross margin normalization.

As we communicated last quarter, we expected that gross margins had normalized, providing a solid baseline for us to build upon moving forward. We generated robust operating cash flow of \$260 million during the quarter, and our disciplined approach to capital allocation further demonstrates our commitment to growth and creating value for shareholders. We completed five acquisitions during and after the quarter to expand our presence in key geographies, gain access to new product lines and add key talent. We also deployed \$100 million to repurchase and retire nearly 2.5 million shares under our share repurchase program.

We operate an asset-light model which has allowed us to convert between 60% to 70% of our adjusted EBITDA into operating cash flow historically. We expect to maintain that same level of operating cash flow generation going forward, resulting in significant available capital that we will reinvest back into the business and return to shareholders.

Turning to acquisitions. We highlighted the acquisition of HM Pipe Products, GroGreen Solutions, and Green Equipment Company in our second quarter call in September. We completed two more acquisitions since then, including Eastcom Associates and ARGCO Northeast.

Eastcom Associates is a distributor of utility protection equipment with a single location in New Jersey. Since 1972, the Eastcom team has provided exceptional service to surveyors and contractors across 13 states, by

offering damage prevention equipment, training and services. They have a strong reputation for their commitment to being dependable partner and we are excited to welcome them to the Core & Main family.

ARGCO Northeast is a single branch distributor of fire protection products and services operating in New Jersey. They have become a trusted partner to the customers they serve, delivering top quality fire protection products and outstanding support. They mirror our own level of commitment to customers here at Core & Main. We look forward to partnering with them to further our customer success.

On a combined basis, the five acquisitions we completed during and after the quarter generate roughly \$150 million of annualized net sales. And year-to-date, we have now completed 10 acquisitions with combined annualized net sales of approximately \$620 million.

Integrating new businesses is a complex process that involves aligning diverse systems, operations and cultures to create one cohesive organization. Our integration process is well-defined, scalable and highly flexible based on the needs of each acquisition. With an experienced team, deep relationships with high-performing companies, and a reputation as the acquirer of choice in our industry, we remain well-positioned to grow through acquisitions for many years to come.

Lastly, I'll wrap up my prepared remarks with our key investment highlights and what makes Core & Main an exceptional business. Core & Main stands out as an industry leader in a large and growing \$39-billion addressable market. We are one of only two national distributors competing in our space with the remainder of the market served by hundreds of other local and regional distributors. Our local presence and expertise are backed by national scale. We can utilize our size and resources to capitalize on new growth opportunities, strengthen our competitive edge, deliver even better products and services that support our customers.

As I mentioned earlier, the end markets we serve are supported by secular tailwinds, including the undersupply of housing relative to population growth and household formations, the critical need to repair and upgrade municipal water systems, and a growing focus on water sustainability. We have multiple levers to drive organic growth, including investments in greenfields, the addition of new sales talent, our ability to drive the adoption of new products throughout the industry, and our relentless focus on proving our value proposition at the local level.

We also have multiple levers to drive sustainable margin expansion, including the expansion of our private label portfolio, optimizing the way we source and price our products and driving operational efficiencies throughout our vast distribution network. Our ability to identify, execute and integrate acquisitions has been a cornerstone of our success, enabling us to expand our capabilities, increase market share, and deliver synergies across our network.

Core & Main is not just a distributor. We differentiate ourselves through a comprehensive portfolio of product and service offerings enhanced by proprietary technology tools that streamline workflows, improve efficiency, and deliver a superior experience to our customers. We are a trusted source to our customers because of our operational excellence across all products, services and markets. Very rarely do our customers come to us with a list of materials. Instead, they come to us with a project idea or engineered drawing, and we bring those projects to life by converting them into comprehensive material project plans.

Our geographic footprint and reach to local communities is also essential to our suppliers, as we have a large and highly knowledgeable sales force with boots on the ground and the ability to reach our fragmented customer base. With a resilient financial profile characterized by strong cash flow generation, disciplined capital allocation and attractive return characteristics, Core & Main is well-positioned to create and deliver value for shareholders, while fulfilling its mission to advance reliable infrastructure across the communities we serve.

Before I turn it over to Mark, I want to take a moment to reflect on the past few quarters. Our teams have had to navigate several challenges and distractions from dynamic market conditions to unprecedented weather events and other external factors beyond our control. Our teams consistently rose to the occasion, demonstrating focus, agility, resilience and commitment. Their continued ability to adapt, collaborate, focus on our customers and drive results speaks volumes about the strength of our culture and the dedication of our people.

Thank you for your ongoing support. I look forward to what we will accomplish in the years ahead. Go ahead, Mark.

Mark R. Witkowski

Chief Financial Officer, Core & Main, Inc.

Thanks, Steve. I'd also like to extend my thanks to our teams for their hard work in delivering another record quarter. We grew net sales approximately 12% in the third quarter to \$2.04 billion. As Steve mentioned, this was the highest level of quarterly sales in the company history. Acquisitions contributed about 9% of our sales growth, and organic volumes were up mid-single digits due to a rebound in municipal project starts and more favorable weather conditions, which allowed our customers to resume some of the projects that were deferred last quarter.

As anticipated, pricing remained stable on a sequential basis. Gross margins for the quarter finished at 26.6%, compared with 27% in the prior year, a difference of approximately 40 basis points. During our second quarter call in September, we communicated our expectation that gross margin normalization had run its course and that we would be in a position to expand gross margins sequentially through the execution of our initiatives. Our teams delivered on that, delivering strong execution to expand gross margins by 20 basis points from the second quarter.

Selling, general and administrative expenses increased 14% in the third quarter to \$274 million. The year-over-year increase in both SG&A, and SG&A as a percentage of net sales, primarily reflects the impact of acquisitions. Interest expense in the third quarter was \$36 million, compared with \$20 million in the prior year. The increase was primarily due to the addition of the \$750-million term loan due 2031, and higher borrowings under our Senior ABL credit facility.

The provision for income taxes in the third quarter was \$47 million, compared with \$39 million in the prior year and our effective tax rates were 25.1% and 19.8%, respectively. This quarter's effective tax rate reflects a more normalized ongoing rate, and the increase over the prior-year period was primarily due to exchanges of partnership interests in conjunction with secondary offerings and the repurchase transactions we completed in fiscal 2023.

We recorded \$140 million in net income in the third quarter, compared with \$158 million in the prior year. The decrease in net income was primarily due to higher SG&A and amortization expenses and an increase in interest expense. Diluted earnings per share increased approximately 6% in the third quarter to \$0.69. The increase in diluted earnings per share was due to lower share counts following the share repurchase transactions executed throughout fiscal years 2023 and 2024, partially offset by a decline in net income.

Adjusted EBITDA in the third quarter increased approximately 7% to \$277 million. Adjusted EBITDA margins decreased 60 basis points year-over-year to 13.6%, reflecting a 50-basis-point sequential improvement from the second quarter.

Moving to our balance sheet and cash flow. We ended the quarter with net debt of approximately \$2.4 billion, and our net debt leverage was 2.7 times. Total liquidity was \$1 billion, consisting of \$10 million of cash and the remaining amount being excess availability under our ABL revolver. We generated \$260 million of operating cash flow during the quarter, reflecting over 90% conversion from adjusted EBITDA. We continue to strategically allocate our cash flow, and our capital allocation priorities remain unchanged with investments in growth being our top priority. This year, we have completed 10 acquisitions and we continue to have a healthy pipeline.

Our second priority is returning capital to shareholders and in the third quarter, we deployed \$100 million to repurchase and retire 2.46 million shares under our share repurchase program. This brings our year-to-date share repurchases to \$121 million and 2.89 million shares in total. As of today, approximately \$379 million remains under our existing share repurchase authorization.

Before we head to Q&A, I'll wrap up my prepared remarks with a discussion on our updated outlook for fiscal 2024 and a framework to consider for fiscal 2025.

The municipal repair and replacement portion of our business remains resilient, and we continue to expect that our end markets will be stable for the remainder of fiscal 2024. We expect the pricing environment to remain sequentially stable and we believe our gross margins will sustain at current levels through the fourth quarter. With three quarters of the year behind us and considering our recent acquisitions, current backlogs and order trends, we are raising our full-year estimates for net sales and adjusted EBITDA. We now expect net sales to range from \$7.35 billion to \$7.45 billion and we expect adjusted EBITDA to range from \$915 million to \$935 million. This will mark our 15th consecutive year of positive sales growth, averaging approximately 10% annually over that period.

The consistency of this growth would not be possible without our resilient business model, the diversified end market mix we've developed over the years, the targeted investments we are making to support and execute our growth initiatives, and the expertise and dedication of our associates. As we look beyond this year, our growth algorithm remains firmly intact.

We plan to provide our outlook for fiscal 2025 during next quarter's earnings call. However, as we sit here today, we generally expect end-market volumes will be positive next year depending on broader economic conditions, including the effect of interest rate movements and progress on federal infrastructure funding. We are committed to driving 2 to 4 points of organic above-market growth through the execution of our product, customer and geographic expansion initiatives.

In terms of M&A, we anticipate 2 points of growth from acquisitions that have already closed so far this year. We maintain a strong pipeline of acquisition opportunities and expect to remain acquisitive as we progress through the rest of this year and into next year.

We're optimistic about our ability to achieve 30 to 50 basis points of adjusted EBITDA margin expansion annually through the execution of our initiatives, and we will strive to do this while producing strong operating cash flow at a rate of 60% to 70% of adjusted EBITDA on an ongoing basis.

We will continue deploying capital on initiatives that will drive above-market growth, including executing on our M&A pipeline and delivering on our organic growth initiatives. We will maintain significant liquidity and balance sheet flexibility to continue driving shareholder value through share repurchases or dividends.

We have demonstrated that our business model is resilient, and we can deliver strong results in any environment. We're looking forward to a strong finish to the year and helping our customers build more reliable infrastructure.

At this time, I'd like to open it up for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question for today comes from Kathryn Thompson of Thompson Research Group. Your line is now open. Please go ahead.

Kathryn I. Thompson

Analyst, Thompson Research Group LLC

Q

Great. Thank you for taking my questions today. The first is just on focusing on end markets and kind of first focusing on the municipal end market in particular. You have current expectations for up low-single digits for 2024, and not that we're necessarily looking for 2025 guidance, but any thoughts on kind of the pace and momentum going into next year with the large amounts of IIJA money still to be spent?

And the municipalities grant are generally steadier versus end markets, but there could be some unique tailwinds helping with that end market. And if you could have just a similar commentary on the non-res end market, too, against the same backdrop. Thank you.

Stephen O. LeClair

Chief Executive Officer & Chair, Core & Main, Inc.

A

Okay. Thanks, Kathryn, for the question. Yeah, we saw really pretty stable and modest growth in municipal through the quarter. And we saw the bidding activity and backlog continue to improve, really feel encouraged by what we're seeing. IIJA funds are starting to become a little bit more prominent out there. So, we're seeing a number of projects that are really hitting the – going from the drawing table to ultimately being executed in projects which we think will start delivering in 2025. And these projects vary from what I would call large diameter, bigger projects, to some of the lead replacement pipes, which can be smaller dollars and a little less material for us, but it's good to start seeing those funds starting to flow through. So, we're encouraged by what we're seeing with municipal. Very much in line with what we were anticipating along those lines.

Non-residential has been good for us as well, too. So, we've certainly seen, roads and bridges, and some of those areas continue to be strong. A lot of the big megaprojects continue to be robust, as we've seen some of the localized areas there in terms of our fire protection activity and along with our underground work in those areas. So, those things have really helped pull through a lot of the storm drainage materials and some of those products as well. So, we'll continue to see that.

Non-residential, we talk about multi-family still struggling and still down, but that was anticipated. So overall, we're encouraged by what we're seeing in the end markets as we get into the fourth quarter and then start 2025.

Kathryn I. Thompson

Analyst, Thompson Research Group LLC

Q

So, just stepping back [indiscernible] (00:26:56), is it a fair assessment to say that momentum is generally better versus declining, as you head into next year?

Stephen O. LeClair

Chief Executive Officer & Chair, Core & Main, Inc.

It's stable. Yeah, definitely stable. And we're definitely seeing some really good pockets, particularly municipal, starting to gain some traction.

A

Kathryn I. Thompson

Analyst, Thompson Research Group LLC

Okay. And one follow-up just on the guidance raise, just a clarification. If I missed this in the prepared commentary, apologies on my end. But in terms of the raise, how much was driven by acquisitions in the quarter, or just a little bit better expectations? Just any color you can give just in terms of the breakout between those three buckets. Thank you.

Q

Mark R. Witkowski

Chief Financial Officer, Core & Main, Inc.

Yeah. Thanks, Kathryn. This is Mark. Appreciate the question. In terms of the guidance raise that we had, I'd say that was primarily due to the acquisitions that we closed subsequent to our last quarter's call. So, we did have those acquisitions close and we added those to the guide. I'd say we had a little bit better beat than our internal expectations and rolled that through into the guide as well. And, obviously, you heard Steve's comments about the outlook and how we're feeling about the balance of the year gave us confidence to roll that through. And then a little bit more, given the optimism on the end markets.

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Kathryn I. Thompson

Analyst, Thompson Research Group LLC

All right. Thank you so much.

Q

Mark R. Witkowski

Chief Financial Officer, Core & Main, Inc.

Thanks, Kathryn.

A

Operator: Thank you. Our next question comes from David Manthey of Baird. Your line is now open. Please go ahead.

David John Manthey

Analyst, Robert W. Baird & Co., Inc.

Yeah. Thank you. Good morning, everyone. First question, it just feels like as we look into fiscal 2025, it is feeling more like a normal year relative to your growth algorithm on slide 12. Could you just -- as you think about that, are there any unusual year-to-year factors on either growth or margin enhancement that we should consider as we look to model the next fiscal year?

Q

Mark R. Witkowski

Chief Financial Officer, Core & Main, Inc.

Yeah. Thanks, Dave. Yeah. In terms of 2025, I think you're right on. That's how we're thinking about it at this point. Obviously, still early yet, but definitely looking forward a more typical year as we think about the end markets. We think those are going to be slightly positive as we sit here today, good execution across the board on

A

our initiatives that we've had this year, and feel like that's going to play into next year really, really nicely into that 2 to 4 points of above-market growth.

From a, I'd say an operating margin standpoint, fully expect to deliver on our commitment of adding 30 to 50 basis points of operating margin next year. We've got some good momentum. You saw us increase gross margins sequentially from Q2 to Q3. And in addition to that, our SG&A rate improved sequentially from last quarter as well. So, got some good momentum here going into the fourth quarter. And like what we're seeing so far for the end markets in 2025.

David John Manthey

Analyst, Robert W. Baird & Co., Inc.

Q

Okay. And then second, a little bit more broad here. Obviously, we've been getting a lot of questions on presidential policy and that sort of thing. Could you talk about both labor conditions and tariffs? I would assume labor, just given the technical nature of your customers' workforce, you probably don't have much in the way of immigration policy change risk there, but can you talk about that? And then tariffs, just if you could address the percentage of COGS that comes from Canada, Mexico or other outside US?

Stephen O. LeClair

Chief Executive Officer & Chair, Core & Main, Inc.

A

Yeah, Dave, really hard to predict what would happen in terms of the labor situation over there. My best guess is that we wouldn't see much of a change at all for the type of contractors that we're dealing with here.

In regards to the tariffs, generally, we view tariffs as a neutral to positive type impact for our business. Very little of our product, most of them – the vast majority of our product is assembled and produced here in the United States, less than 15% comes in as import. And for our direct import that we do ourselves, it's less than 2%. So, we generally don't see a huge impact from the tariffs. And if anything, it's, as we said, neutral to positive as we look at that going into this new administration.

David John Manthey

Analyst, Robert W. Baird & Co., Inc.

Q

Thank you very much.

Stephen O. LeClair

Chief Executive Officer & Chair, Core & Main, Inc.

A

Thanks, Dave.

Operator: Thank you. Our next question comes from Nigel Coe of Wolfe Research. Your line is now open. Please go ahead.

Nigel Coe

Analyst, Wolfe Research LLC

Q

Thanks. Good morning. And Mark, I think you've just given 2025 guidance, so thanks for that. But, yeah, so just taking a step back to 3Q, sales came in quite a bit better than what you expected. So, I'm just curious, you know, what drove the upside to your expectations. And any thoughts on how much of the 2Q projects that were impacted by the weather came in and benefited 3Q?

Mark R. Witkowski

Chief Financial Officer, Core & Main, Inc.

A

Yeah. Thanks, Nigel. Yes. In terms of the quarter, I would say it came in slightly better than our internal expectations. Obviously, we had a decent beat to consensus on the top line and EBITDA margins, but we were expecting a better construction cycle here in Q3 relative to the impacts that we saw in Q2. So, we did see some of that release into Q3, but it really got us back on trends that we were expecting and really were expecting to see throughout that quarter.

Gross margins came in nicely like I mentioned sequentially. We were expecting some improvement there. But that probably came in slightly better as well than what we're expecting. So, overall, we were pleased to see us get back on the trend lines that we expected to be for really this year outside of the impacts that we saw in Q2.

Some of those projects – I'd say some of those projects have all released through. There's probably a little bit more that we would expect in Q4, just depending on how late the construction season goes, in particular in some of these northern geographies. So, overall, feel good with the performance in the quarter.

Nigel Coe

Analyst, Wolfe Research LLC

Q

Great. Thanks, Mark. And then on pricing, your comment to us sequentially stable into the fourth quarter. I'm curious, any perspectives on 2025, are we getting beyond now the fire protection, price deflation? And if you could maybe comment on the PVC pipe pricing environment, that's obviously a hot topic right now.

Mark R. Witkowski

Chief Financial Officer, Core & Main, Inc.

A

Yeah, I'd say overall, as we sit here today, we're expecting really a neutral impact in 2025, with the pricing. I'd say no really significant contributors, either positively or negatively for 2025. I'd say on the steel pipe side, we've seen that decline throughout 2024. We do think it kind of bottomed out in Q3. We started to see some momentum there, but we will have a headwind there as we get into the early part of the year. PVC, again, less than 15% of our business, but has been relatively stable here throughout 2024. And no real expectations for significant movement going into next year as we sit here today.

So, hopefully, we got the steel pipe side and the fire protection behind us. And we're seeing some other good information coming in from various suppliers, good trends in a lot of these product categories. So, that's kind of what leads us to believe at this point that neutral is a good estimate at this point for 2025.

Nigel Coe

Analyst, Wolfe Research LLC

Q

That's great. Thank you.

Operator: Thank you. Our next question comes from Mike Dahl of RBC Capital Markets. Your line is now open. Please go ahead.

Mike Dahl

Analyst, RBC Capital Markets LLC

Q

Thanks for taking my questions. I want to stick with the pricing environment for my first one. Obviously, as Nigel said, it's a hot topic right now. Some of your – some users of pipe, some suppliers of pipe, they do – while pricing

seems like it may not have come down significantly on the muni side yet, I think there are still some comments out in the industry about expectations for a continued decline. So, your comments probably stand out as a little bit different there, Mark. So, maybe you guys can give a little more color, specifically on the muni side, on what you're seeing, what you're hearing, what gives you the confidence that might be more stable through next year?

Stephen O. LeClair

Chief Executive Officer & Chair, Core & Main, Inc.

A

Yeah, Mike, good question. Obviously a lot of attention on PVC, but I want to talk a little bit about what – when we talk about stable pricing, what that really means for us. So, most of our sales are project-based. So, our customers really are looking for us for a full suite of products associated to complete a project. So, within that, there are numerous different product categories, well beyond PVC pipe.

And so, pricing itself is really based on a lot of different factors, whether it's demand and competition in the local market, complexity of the project, local specifications, and the price for which we procured the product. So, when we talk about stable pricing, we're talking about stabilization across a lot of those different product categories, a lot of the different value that we can add into these projects in regards to the project management, the delivery, the quality of service, etcetera, and so, when we talk about where we're seeing stable pricing environment, that's what we're talking about.

As Mark mentioned, less than 15% of our product is PVC related, and many projects don't even have PVC associated with it. We're already starting to see – most of our manufacturers are seeing increases in their cost. So, we're already starting to see price increases for many different product categories coming in now for 2025. So that's what gives us confidence right now for about a stable pricing environment.

Mike Dahl

Analyst, RBC Capital Markets LLC

Q

Okay. Yeah, that's really helpful. And I think that's the nuance we were looking for, and it's important for people to understand in terms of multi-product jobs, service orientation, and at a job level, the stability.

I guess the second question, you spent some time talking about the water treatment initiatives, and obviously that's part of a broader portfolio of growth initiatives that are building into your above-market growth expectations. Can you just give us – there have been a couple different adjacency expansions, but help us kind of frame up like the opportunity and kind of the near and medium-term as you think about some of the big ones like treatment plants, like what's that specifically contributing to your expectations around the 2025 growth?

Stephen O. LeClair

Chief Executive Officer & Chair, Core & Main, Inc.

A

Yeah, we won't break that out specifically. But what I'd share with you is that over the last 10 years, we've really been building our capabilities in this space. It is very long-cycle type work. A lot of the projects that are being executed now are ones that were, you know, really were working on five-plus years ago, where we've gone through a lot of the design work initially with a lot of these contractors to help design and optimize the material flow to these projects. And these projects will carry on for – generally have a duration, for us, once they're starting into the execution, for multi-years.

So, that's why we like this business. It's one of those areas we've been able to invest in because we've got a long view on the industry, getting access to the products associated with this. These are specialty type products, especially lined products. All of them require special access and we've been able to build that capability over the

last decade. And so, we'll continue to see a lot of growth in that as the population expands and water treatment, and wastewater facilities continue to expand and new ones being developed and designed are right there in the forefront of these things and have a long pipeline ahead of us for projects to execute on.

Mike Dahl

Analyst, RBC Capital Markets LLC

Great. Thanks, Steve.

Stephen O. LeClair

Chief Executive Officer & Chair, Core & Main, Inc.

Thanks, Mike.

Operator: Thank you. Our next question comes from Sam Reid of Wells Fargo. Your line is now open. Please go ahead.

Sam Reid

Analyst, Wells Fargo Securities LLC

Awesome. Thanks so much, guys. Wanted to ask if you could rank order in perhaps greater detail, the building blocks behind the sequential improvement in gross margin. I know you've already touched on some of these, but maybe just put a finer point on any benefit from acquisition accretion versus some of your self-help initiatives like strategic sourcing and private label. And then apologies if I missed, but do you have an update on where private label sits as a percent of COGS? Is it still at 2%, or was there an increase in Q3 versus Q2?

Mark R. Witkowski

Chief Financial Officer, Core & Main, Inc.

Yeah. Thanks, Sam. I'll take that one. In terms of the sequential improvement in gross margins, you saw we increased about 20 basis points since last quarter. I'd say in terms of the ranking there, the first and foremost was just strategic sourcing and some of the optimization work that we've done there made a lot of really good progress on that throughout the year. Then probably rank private label second, was a good contributor, and we've continued to make really good progress there.

I'd say we're kind of in the range of 2% to 3% of COGS on private label. We've advanced that pretty well since we updated that figure last, and we'll be providing some more detail on that in terms of how we wrap up the full-year from a private label standpoint and, obviously, expectations about where we think that can go. But, I'd rank them there, sourcing, optimization and private label, no real acquisition contribution sequentially there. We did have some benefit year-over-year from an M&A standpoint at gross margins, but not a significant contributor sequentially.

Sam Reid

Analyst, Wells Fargo Securities LLC

No, that helps. And then to follow up on the election question, another broad one here, any signs of interest in onshoring, given some of the policies of the incoming administration, some of the things they're looking to incentivize, and if we were to see those large onshoring type projects emerge, any sense as to when those projects would start to benefit your P&L specifically?

Stephen O. LeClair

Chief Executive Officer & Chair, Core & Main, Inc.

A

Yeah, Sam, really way early innings on this one to really understand what our manufacturer sentiment would be about onshoring. I will share with you that the vast majority of our manufacturers are onshore today. It'll be interesting to see if there's other components, or, etcetera, that they're looking at, at maybe onshoring, but it's hard to tell. I mean, we're just weeks into this thing and those cycles tend to take a little bit of planning on our manufacturers' standpoint to do that. So, we'll see how that plays out. Maybe have a little bit more color for you on the next quarter.

Sam Reid

Analyst, Wells Fargo Securities LLC

Q

No, that helps. Thanks so much.

Operator: Thank you. Our next question comes from Patrick Baumann of JPMorgan. Your line is now open. Please go ahead.

Patrick Baumann

Analyst, JPMorgan Securities LLC

Q

Hi. Good morning. Thanks for taking my questions. Appreciate the 2025 end market margin [indiscernible] (00:43:46) Can you talk about what's been allocated out of that I think it was \$55 billion of funding for water from IIJA? Like what's still to come and why it's been so slow to develop, and kind of what's the upside to that low-single-digit growth rate when this comes?

And then on non-res, if you could comment on – if you have exposure to data center development, what that might be, and could that be a meaningful tailwind for that non-res end market for you, or not really? Just curious what you do from a data center perspective.

Mark R. Witkowski

Chief Financial Officer, Core & Main, Inc.

A

Yeah. Thanks, Pat. Appreciate the questions. I'll try to tick through those. But on the IIJA funding, we still haven't seen a majority of that get down to the state level. The federal allocation there really needs to be pushed down and allocated into those state revolving funds. And then that's when local municipalities can go in and access those funds. So, there's still a lot more funding there to be allocated. But like Steve mentioned early, we are really optimistic with some of the movement we saw in particular this quarter with a lot more projects being bid and applied for funding there. So, I do expect that momentum to continue and be a tailwind for us as we get into 2025.

As it relates to megaprojects and data centers, I'd say we participate significantly in those. We've seen a lot of those projects all around the country. We participate in a lot of ways initially with all of the infrastructure needed for water, sewer, storm drainage, there's a pretty significant amount of infrastructure that goes in. And then in some cases, there's fire protection product that's addressable us in those facilities. But, you know, that's been a good area of momentum that we've seen in the non-resi space, and we'll continue to participate in those. We continue to see more and more of those pop up throughout the country and we're well-positioned to capture that growth.

Patrick Baumann

Analyst, JPMorgan Securities LLC

Q

On the \$55 billion of funding from IJJA, is it like a 10% of that being allocated, 20%, do you have any sense of numbers? Is it 50%? Like how much – any sense on how much has been allocated so far?

Mark R. Witkowski

Chief Financial Officer, Core & Main, Inc.

A

Pat, our best sense of that in terms of how much has been allocated, it's roughly about a third of it at this point. So, still a lot of room there for additional funding growth.

Patrick Baumann

Analyst, JPMorgan Securities LLC

Q

Okay. And then on the acquisition side, my second question, you've now done a couple of deals for these, I guess, distributors of instruments in utility locating, the damage prevention equipment, that sort of thing. Can you provide a bit more color on these, like what's the opportunity here to scale this across the network? Is this a higher-margin product set? Any more color you can provide? I think it was Green Equipment and then the Eastcom [indiscernible] (00:46:54) you talked about today.

Stephen O. LeClair

Chief Executive Officer & Chair, Core & Main, Inc.

A

Yeah, yeah. Patrick, both of those are really good businesses in regards to doing a lot of the utility servicing type areas with line detection and things along those lines. We think now we cover a good number of states. We're getting access to that product, which is something that our – all of our customers are pulling through at this point. They've been buying it from other sources. We believe we can add a lot of value in this and continue to do that.

In the big scheme of things, it's probably not something that we view as a multibillion-dollar market by any means, but it is a great complementary offering to what we're already serving and providing to our municipal customers across the board. And these utility detection devices are fairly technologically advanced. You get into radar and different types of things that are just really useful right now as these municipalities are looking to locate services that, quite frankly, have been buried for 60 to 70 years, and help facilitate a lot of the replacement of the product and the pipe that's in there.

Patrick Baumann

Analyst, JPMorgan Securities LLC

Q

Helpful color. Thanks. Thanks a lot. Appreciate it.

Stephen O. LeClair

Chief Executive Officer & Chair, Core & Main, Inc.

A

Yes.

Operator: Thank you. Our next question comes from Joe Ritchie of Goldman Sachs. Your line is now open. Please go ahead.

Joe Ritchie

Analyst, Goldman Sachs & Co. LLC

Q

Thanks. Good morning, everyone. So, I just want to maybe start by...

Stephen O. LeClair

Chief Executive Officer & Chair, Core & Main, Inc.

Hey. Good morning, Joe.

A

Joe Ritchie

Analyst, Goldman Sachs & Co. LLC

...squaring your comments on – hey, good morning. I just want to start by squaring the comments on organic growth. It seems like volumes are up, call it 4% to 5% this quarter. I know you have an extra week in the fourth quarter, and it seems like the volumes ex the 53rd week, I think your guidance is implying slightly down. I just want to make sure I had that straight, and if so, anything you guys want to call out there?

Q

Mark R. Witkowski

Chief Financial Officer, Core & Main, Inc.

Yeah, Joe, you're pretty, pretty close on that in terms of the mid – I'd say mid-single-digit volume growth for the quarter. I'd say expectations that we've got embedded in the guide for Q4, obviously, it's a much more of a seasonal quarter for us. So, I'd say more in the like – kind of call it neutral to slightly positive volumes in the fourth quarter. And then, obviously, depending on the seasonal impacts that we see, that could move around a little bit. The 53rd week, that'll be worth somewhere in the 6 to 8 points of revenue growth in the quarter. So, get a little extra benefit there with the extra week.

A

Joe Ritchie

Analyst, Goldman Sachs & Co. LLC

Okay, great. That's helpful, Mark. And then Steve, maybe going back to your comment from earlier around the delay you typically see when there's storm-related activity, and the uptake that you see in your business. I guess, from all of the weather-related issues that we've seen this year, I mean, would you start to expect to see maybe some improvement or some bump in your business in the early parts of 2025? Does that start to come in, maybe even this quarter? Just any thoughts around that would be helpful.

Q

Stephen O. LeClair

Chief Executive Officer & Chair, Core & Main, Inc.

Yeah, we definitely could see something coming into 2025. What I'd share with you is that in Q2, the weather-related incidents we had were incredibly pervasive, from Texas all the way up into Wisconsin, all the way up North into the upper Midwest. And that obviously had a huge impact on us in the second quarter.

A

If you look at kind of what happened really in this third quarter with the hurricanes, the back-to-back hurricanes with Hilton – Helene and Milton, both of those were fairly localized, and obviously caused a pause in some construction related activity that was happening there. We – we'll continue to see that evolve and start to release into the fourth quarter.

And then in the medium and longer term, what we generally see are a much more robust replacement of water and storm drainage systems across the – across those areas that were impacted. Some of them were completely wiped out in the Carolinas, and that's going to be a total rebuild in those areas for many of the utilities out there. So, we'll continue to see some of that move into 2025 for sure.

Joe Ritchie

Analyst, Goldman Sachs & Co. LLC

Q

Okay. Great. Thanks, guys.

Operator: Thank you. Our next question comes from Keith Hughes of Truist. Your line is now open. Please go ahead.

Keith Hughes

Analyst, Truist Securities, Inc.

Thank you. Two questions. First, on the units, and you've talked about this in several calls, but it was a pretty notable turnaround from the negative numbers you had in the second quarter. Would there be any region that you would call out that was particularly strong during the period or any specific end user market around that third quarter number?

Mark R. Witkowski

Chief Financial Officer, Core & Main, Inc.

Yes. Thanks, Keith. In terms of the regions, I would say, the area that we were impacted by last quarter was really up and down through the central part of the US. And in the third quarter, we definitely saw construction resume in that area. So, that was really good to see for those parts of the country where they weren't able to complete a lot of that underground construction in Q2. So, we did see that come back nicely. I'd say municipal also rebounded. We were pleased to see some of the starts get back online with the activity that we were expecting.

It was a little tricky for us to call that last quarter and we're really pleased with how that came in in the third quarter. Really resi and non-resi, I'd say, both kind of came in fairly stable and in line with what our expectations were. So, those are the priority areas that I'd highlight and call out.

Keith Hughes

Analyst, Truist Securities, Inc.

Okay. And this has been referred to by several callers, but some of your suppliers have been receiving subpoenas around antitrust issues. Have you received – are you party to any of these subpoenas?

Stephen O. LeClair

Chief Executive Officer & Chair, Core & Main, Inc.

No, we have not received any subpoenas, anything along those lines. And just to reiterate, we are not named as a defendant in any of those cases, and we won't comment on anything regarding any of our suppliers, and in terms of the activity that's happened, we hold by our statements that we made last quarter.

Keith Hughes

Analyst, Truist Securities, Inc.

Okay. Great. Thank you.

Operator: Thank you. Our next question comes from Anthony Pettinari of Citigroup. Your line is now open. Please go ahead.

Anthony James Pettinari

Analyst, Citigroup Global Markets, Inc.

Hi. Good morning. I was wondering if you could talk a little bit about how the M&A pipeline looks in general for 2025, and are you seeing any kind of increased competition for targets, or maybe new potential buyers, or

valuations that maybe are less reasonable than you've seen in the past? And then just generally, with net leverage at 2.7 times, healthy, but a bit above the 2 times that you talked about at the Investor Day, just wondering if you can talk about what level of leverage you're willing to go to and just how we should think about that maybe next year.

Stephen O. LeClair

Chief Executive Officer & Chair, Core & Main, Inc.

A

Yeah. Anthony, I'll talk about the M&A pipeline. So, really everything that we've looked at so far this year and our pipeline that we've got going into next year, continues to remain very strong. Many cases that we're looking at, these have been sole sourced deals that we've been working with directly with owners along those lines.

We pride ourselves in being the acquirer of choice in the space. The multiples that we're looking at are right in line with traditionally what we have continued to execute on through the last several years. So, really don't see much change in that. The pipeline has been robust, as you saw this year, and we've already executed 10 deals, so far, this year. Continue to see a robust pipeline going into 2025 and would expect the same. Mark, you want to talk little bit about leverage?

Mark R. Witkowski

Chief Financial Officer, Core & Main, Inc.

A

Hey, Anthony. In terms of leverage, we're going to continue to maintain a conservative balance sheet with pretty significant liquidity throughout. We're obviously expecting to generate pretty good amount, right, over \$250 million of cash in the fourth quarter. So, I believe we'll have ample capacity to continue on our M&A strategy, continue a balanced approach to capital allocation, with potential share repurchases and that sort of thing, while maintaining leverage in a very reasonable line. And we've laid out a target somewhere 1.5 to 3 turns for debt leverage and very confident we're going to stay within that that guidance that we have put out.

Anthony James Pettinari

Analyst, Citigroup Global Markets, Inc.

Q

<Q>: Great. Great. And then just one follow-up. I mean, a lot of your M&A has been kind of about expanding the product offering. I was just curious, is there any kind of geographic whitespace or region that you're looking to enter that are worth noting?

Stephen O. LeClair

Chief Executive Officer & Chair, Core & Main, Inc.

A

Yeah, the filling areas that we've had, we continue to find great opportunities out there. We've done a number of bolt-on acquisitions this year. We've strengthened our positions in Arizona, Nevada, even in Texas and some of these other areas. So, there continues to be a lot of robust areas in these local markets to continue to do that. We also added in HM Pipe Products in Canada. And so, we continue to look at the map on where we're at and continue to find opportunities.

Some cases there's really good acquisition targets in there and other cases we find is a great opportunity to do the greenfields that we've been rolling out as well, too. So, we'll look at it along those lines. A lot of great – a lot of space left for us to fill in a lot of dots out there.

Operator: Thank you. Our next question comes from Matthew Bouley of Barclays. Your line is now open. Please go ahead.

Matthew Bouley

Analyst, Barclays Capital, Inc.

Q

Good morning, everyone. Thank you for taking the questions. Actually, on that last point, Steve, you mentioned the greenfields. I think you opened a couple in the quarter, and you mentioned that there's kind of a pipeline of priority markets going forward. So, I guess, what is the typical ramp timeline of a greenfield branch for you guys in terms of hitting kind of normal branch revenue and profitability? And, I guess, how many greenfields would you look to be opening in 2025? Thank you.

Mark R. Witkowski

Chief Financial Officer, Core & Main, Inc.

A

Yeah. Thanks, Matthew. In terms of the ramp on greenfields, we're typically, I would say, just from an earnings perspective, we're breaking even within the first year. And we're trying to ramp revenue to get to a typical branch size somewhere usually in years three to five. So, that does take a little bit of time there to get mature in a market, but something we're very experienced, and we've got a great track record for rolling those out.

In terms of the pace, it's really dependent upon various factors. So, we don't necessarily set a target for greenfields, but it's definitely a contributor when we talk about 2 to 4 points above-market growth. It's been a contributor there and it'll continue to be a contributor as we move forward. So, you should expect to see continued announcements as we open up in new locations.

Matthew Bouley

Analyst, Barclays Capital, Inc.

Q

Okay. Thanks for that, Mark. And then secondly, I wanted to ask about sort of the near-term margins and what that implies for 2025. I think you said gross margins should be kind of sequentially stable into the fourth quarter. I guess that implies that SG&A dollars might be flattish sequentially, despite, I guess, lower sequential sales. I just wanted to check if that's the case and why that would be the case.

But as you get into 2025 and you talk about 30 to 50 basis points of annual EBITDA margin expansion, given what's happening on SG&A right now, I mean, is the expectation for now that most of that margin expansion would be coming on the gross margin side? Thank you.

Mark R. Witkowski

Chief Financial Officer, Core & Main, Inc.

A

Yeah, Matthew, in terms of the fourth quarter, you're correct that we expect about sequential gross margins into the fourth quarter. From an SG&A perspective, we'll lose a little bit of a leverage into the – in the fourth quarter with the seasonal ramp down in sales. So, the SG&A rate will be a little higher into the fourth quarter, which is typical for us.

As you think about 2025, we're very committed to the 30 to 50 basis points of operating margin improvement. Now, that's going to come from a couple of different areas. One, obviously potentially gross margins and then SG&A productivity. And I'd expect that we'll be in a good position to expand both of those as we go into 2025. So, I – feel really good that we're going to get that productivity out of SG&A and continue to work on our gross margin initiatives that we've laid out.

Matthew Bouley

Analyst, Barclays Capital, Inc.

Q

Got it. Thanks, Mark. Good luck, guys.

Operator: Thank you. Our final question for today comes from Andrew Obin of Bank of America. Your line is now open. Please go ahead.

David Ridley-Lane

Analyst, BofA Securities, Inc.

Thank you. This is David Ridley-Lane on for Andrew Obin. Just a quick sort of clarification question. What percentage of your revenue today is multifamily? And I believe that's – just to confirm that's included in your non-residential category. Correct?

Mark R. Witkowski

Chief Financial Officer, Core & Main, Inc.

Yeah, that's right, David. We grouped multifamily into non-residential primarily because we do a lot of other commercial work as well. And it fits a little better into that bucket for us. But it's, I'd say, less than 5% of our sales fit into that multifamily. We do some of the – obviously the water, sewer, storm drainage around those facilities and then usually there's quite a bit of fire protection component in those types of projects. So, that's really the – what makes up the majority of that participation in that end market.

David Ridley-Lane

Analyst, BofA Securities, Inc.

Got it. And just to put a – I know this has been asked before, but just to put a finer point on it, so, last quarter you said you lost about \$50 million of revenue from the weather. I did check, this quarter is a lot drier. So, did you catch up on the full \$50 million in the third quarter, or do you think that was – it was less than that?

Mark R. Witkowski

Chief Financial Officer, Core & Main, Inc.

Well, we think sequentially, it was obviously a much better construction quarter. So, we got back on to the trend lines that we were expecting to have for Q3. In terms of the projects, it's always difficult to tell exactly, you know, did any of those bump ahead of other projects. But we do feel like a majority of that was – that we achieved a lot of that in the quarter. There's probably some more to come yet in Q4, or that would get pushed into 2025. But I – think about it sequentially, it was an improvement from Q2. As you think about the benefit of it year-over-year, Q3 last year was a decent construction quarter. Generally, the weather was fine. So, really not as much year-over-year benefit, but obviously helped us sequentially from Q2.

David Ridley-Lane

Analyst, BofA Securities, Inc.

Got it. Thank you very much.

Mark R. Witkowski

Chief Financial Officer, Core & Main, Inc.

Yeah.

Operator: Thank you. At this time, we have no further questions, so I'll hand back to Steve LeClair for any further remarks.

Stephen O. LeClair

Chief Executive Officer & Chair, Core & Main, Inc.

Thank you all again for joining us today. Our third quarter performance highlights our resilience, adaptability and commitment to operational excellence. We achieved record sales and maintained strong operational performance underscoring the strength of our business model and our ability to drive growth. By combining our local expertise with our national scale and innovative product offerings, we continue to deliver exceptional value to our customers and stakeholders.

Looking ahead, we remain focused on addressing our customers' critical infrastructure needs as the nation grapples with a widening gap between water supply and demand. With significant federal investments on the horizon, we are well-positioned to capture long-term growth opportunities that exist while delivering sustainable expansion and value creation.

We are energized by the opportunities that lie ahead and are confident in our ability to drive meaningful progress across our strategic priorities. Thank you for your support. We look forward to building on our success in the quarters to come. Operator, that concludes our call.

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Operator: Thank you, all, for joining us today. You may now disconnect your lines.

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