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Core & Main, Inc. (CNM)

Q4 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, everyone, and welcome to the Core & Main Q4 2023 Earnings Call. My name is Karla, and I'll be coordinating your call today. [Operator Instructions]

I will now hand you over to your host, Robyn Bradbury, Vice President of Finance and Investor Relations, to begin. Robyn, you can please go ahead.

Robyn Bradbury

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

Thank you. Good morning, everyone. This is Robyn Bradbury, Vice President of Finance and Investor Relations for Core & Main. We're excited to have you join us this morning for our fiscal 2023 fourth quarter and full-year earnings call.

I'm joined today by Steve LeClair, our Chairman and Chief Executive Officer; and Mark Witkowski, our Chief Financial Officer. Steve will lead today's call with a review of our fiscal 2023 execution highlights. Mark will then discuss our financial results and 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. As a reminder, our press release, presentation and the statements made during this call include

forward-looking statements. These statements are subject to risks and uncertainties that could cause actual results to differ materially from our expectations and projections. 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 our Chairman and Chief Executive Officer, Steve LeClair.

Stephen O. LeClair

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

Thanks, Robyn. Good morning, everyone. Thank you for joining us today. If you're following along with our investor presentation, I'll begin on page 5 with an overview of our unique market position.

Core & Main is a leading specialty distributor of water, wastewater, storm drainage and fire protection products, serving municipalities, private water companies and professional contractors across municipal, nonresidential and residential end markets nationwide. Our specialty products and services are used in the maintenance, repair, replacement and construction of water and fire protection infrastructure.

Our customers partner with Core & Main for our breadth of products and services, extensive industry knowledge, familiarity with local municipal specifications, convenient branch locations, and project management capabilities. We have the ability to serve smaller local customers and larger regional or national customers with relevant expertise, and our sales associates take a consultative approach to provide customer-specific solutions for projects of all sizes. We are deeply involved in our customers' planning processes all the way from project design through project completion.

At the end of fiscal 2023, our footprint consisted of 335 branches across 48 states, which serves as a critical link between approximately 5,000 suppliers and a diverse base of over 60,000 customers. With the closing of Eastern Supply and Dana Kepner acquisitions, we are now operating with more than 350 branches across 49 states. We are a clear industry leader, yet we estimate we have only 17% share of a very fragmented \$39 billion addressable market. Accordingly, our long-term growth opportunity remains significant.

We maintain a diverse end market exposure where roughly 42% of our net sales in fiscal 2023 went towards municipal projects, 38% towards nonresidential projects, and 20% towards new lot development for new residential construction. We are also balanced geographically and across our product lines.

Our end market mix, broad product portfolio and wide geographic coverage offers us multiple avenues to grow and create value for our customers and suppliers while providing resiliency through economic cycles. I'm excited about the opportunities that lie ahead for Core & Main, but I am also very proud of where the business stands today. We are a leader in an industry with secular growth trends. We have multiple levers to drive growth and cash flow. We maintain an efficient cost structure, and we have an industry leading salesforce dedicated to helping communities advance reliable infrastructure.

Turning to page 6. Fiscal 2023 was an exceptional year for Core & Main, given the extraordinary performance we achieved during the preceding two years and considering the softer market conditions that have followed. Our teams navigated the dynamic environment to deliver strong financial performance, including record net sales of

over \$6.7 billion, adjusted EBITDA of \$910 million, and record operating cash flow of approximately \$1.1 billion. Our branches executed at a high level to maintain pricing discipline while executing on our margin initiatives, resulting in positive price contribution for the year and roughly 10 basis points of year-over-year gross margin expansion despite normalizing supply chains.

Our product and customer initiatives produced strong results throughout the year, as we continue to accelerate the adoption of new products in our industry. This includes 16% growth in our smart metering product line, an additional above-market growth in our fusible HDPE offering, and advanced storm water management and erosion control systems. We also increased our share with strategic accounts, who typically pursue large projects that require greater technical expertise and specialized procurement needs like the construction and rehabilitation of water and wastewater treatment facilities.

Each of these are initiatives that we resource for scale and measure with a focus on profitability. These initiatives have produced consistent above-market growth for the business and has accelerated since we became an independent company in 2017.

We opened four new locations in underserved markets in fiscal 2023, building on our commitment to make our products and expertise more accessible nationwide. Greenfields are a powerful way to expand geographically, and we are well-positioned to do so, given our talent pool, scale and lessons learned from past successes. We have opened nearly 20 new locations over the last several years, all of which continue to mature and offer additional growth opportunities.

We welcomed 10 new companies to Core & Main during and after the year, deploying \$780 million to acquire approximately \$700 million of historical annualized net sales. Two of our more recent acquisitions, Eastern Supply and Dana Kepner, were announced and closed after the year.

Eastern Supply is a distributor and fabricator of a wide variety of storm drainage products operating out of locations in Virginia and Pennsylvania. For close to 30 years, the team at Eastern Supply has provided drainage products and related services to contractors, engineers and municipalities across the Northeast. We look forward to expanding our reach in this territory with a team that shares the same commitment to their customers, suppliers and communities.

Dana Kepner is a large multi-region distributor of water, wastewater and storm drainage products operating out of locations across Arizona, Colorado, Nevada, Texas, Wyoming, and New England. Since 1933, the team at Dana Kepner has worked towards becoming the industry experts they are today. They are a highly credible partner in the waterworks industry, and their core values align with our own at Core & Main. Dana Kepner offers a unique opportunity to generate margin expansion and synergistic value through our combined purchasing capabilities, facility optimization, and fixed cost leverage as we drive new revenue-generating opportunities by providing our customers with better access to products and services.

Last week, we also announced the signing of ACF West, a leading distributor of geosynthetic and soil stabilization solutions with locations across Oregon, Washington, Idaho and Utah. For over three decades, the team at ACF West has offered their municipal and contractor customer solutions for geosynthetics, erosion control, storm water management, and terrain stabilization. ACF West is a highly trusted distributor with a longstanding and loyal customer base. We believe that their product and service offerings are an excellent complement to our business, and we look forward to welcoming them into the Core & Main family.

Our acquisition strategy continues to create tremendous value for Core & Main. We have deployed over \$1.6 billion of capital on more than 30 acquisitions since 2017. Our acquisitions continue to add key talent to our business, and they move us towards our goal of providing a complete line of water, wastewater, storm drainage and fire protection products to our customers across the country.

We are honored that so many owners and operators in our space choose Core & Main as a home for their businesses, and many of them continue to thrive in leadership positions throughout our company. These leaders are a powerful force within Core & Main, as they help us improve the value we bring to our customers and suppliers. When blended with our existing talent, we generate new ideas and improve our entrepreneurial agility. We provide them and their teams with access to regional and national resources, a robust training program and advancement opportunities to pursue both their personal and professional passions. Ultimately, we all win together. Our M&A pipeline remains very active, and we expect to continue adding businesses to the Core & Main family throughout 2024 and beyond.

On the margin side, we continue to build out an assortment of private label brands and products used in water, wastewater, geosynthetics, and fire protection applications. We invested in capacity by adding over 80,000 square feet of distribution space and more than 1,000 private label SKUs to our offerings since the end of last year. These private label products typically yield gross margins that exceed our core products by 1.5 to 2 times. We ended fiscal 2023 with private label products representing over 2% of our total COGS, with an opportunity for it to grow in excess of 10%. We expect that our brand recognition, direct sourcing capabilities, and diversified international supplier relationships will continue to create cost advantages well into the future.

We've made great progress in optimizing system-wide pricing through IT enhancements and data-driven analysis. Our teams in the field have the flexibility to price locally when needed, but behind them is a centralized team of pricing analysts using advanced analytics across our extensive transaction set. With real-time pricing data, our local teams can make fully informed pricing decisions, whether they are prioritizing margins or market share gains. The tools and capabilities we built around this team should continue to drive margin expansion well into the future and serve as an enabler on our path toward 15% adjusted EBITDA margins.

We made investments throughout the year aimed at improving our customer experience while making our teams more efficient. Our national operations team partners with our teams in the field to develop and implement operational best practices across the company, which improves our efficiency to help drive EBITDA growth and EBITDA margin expansion.

We also continue to invest in our proprietary digital estimating and bidding platform to create comprehensive material takeoffs for the projects we participate on. Our goal is to efficiently produce the most timely, accurate and professional bids so our customers have the best overall solution for their projects.

We continue to execute on our capital allocation priorities by deploying approximately \$1.3 billion throughout fiscal 2023 to directly repurchase and retire 45 million shares from our former private equity sponsor at an average per share price of approximately \$30. Upon monetizing their remaining stake in Core & Main, their representatives resigned from their board positions.

Subsequent to the end of the fiscal year, we expanded our available capital by adding a \$750 million term loan. This additional financial capacity puts us in a position to continue executing our growth strategy. Mark will provide more details of the new debt later in his prepared remarks.

On page 7, you'll see our track record of performance over the last five years with consistent sales growth and adjusted EBITDA margin expansion. We have numerous opportunities for continued growth, margin expansion and cash flow generation. We are confident in our ability to drive long-term growth and achieve our target of \$10 billion net sales by 2028, while expanding adjusted EBITDA margin percent.

As you can see, Core & Main is built for growth. We have a clear path to \$10 billion of net sales by generating roughly \$1 billion of growth from our end markets, \$1 billion from organic above-market growth, and \$1 billion from M&A over the next five years. We have a machine of idea generation across our network branches. We have a process to convert the best ideas into initiatives and execute on them at scale. We've proven we can add substantial revenue to our business through organic geographic expansion, product line expansion and local share gains. Then we add sustainable margin expansion through pricing analytics, sourcing optimization, private label, and operational excellence. And then we compound it all through M&A, and that is an exciting formula for growth.

As I wrap up my prepared remarks, I want to share that I'm extremely proud to see our vision of advancing reliable infrastructure realized over time. Our teams across the country have elevated Core & Main into an industry leader that can be relied on to deliver local knowledge, local experience, and local service nationwide. We have generated a significant amount of momentum for the business in recent months between the acquisitions we completed, the internal investments we made, and the value we return to shareholders, and we look forward to continue capitalizing on that momentum in fiscal 2024.

With that, I will now turn it over to Mark to discuss our financial results and fiscal 2024 outlook. Go ahead, Mark.

Mark R. Witkowski

Chief Financial Officer, Core & Main, Inc.

Thanks, Steve, and good morning, everyone. I'll begin on page 9 with highlights of our fourth quarter results.

We reported net sales of over \$1.4 billion in the fourth quarter. As a reminder, the fourth quarter is traditionally our lowest volume quarter due to seasonality. However, we were pleased with a 5% increase compared with the prior year. Acquisitions contributed approximately 3 points to the net sales growth, while organic volumes were up low single digits.

Gross margin of 26.7% was 40 basis points lower than the prior year, as inventory costs continue to catch up with market prices. We anticipated gross margin normalization in the fourth quarter. However, the result was better than expected due to the execution of our gross margin initiatives and benefits from acquisitions.

Selling, general and administrative expenses increased 8% to \$230 million for the fourth quarter. The increase in SG&A reflects the impact of acquisitions, cost inflation and investments to drive growth.

Diluted earnings per share in the fourth quarter was \$0.34, an increase of 10% compared with the prior-year period. Diluted earnings per share increased due to lower share counts following the share repurchase transactions we completed during the year.

Adjusted EBITDA decreased approximately 2% to \$160 million, and adjusted EBITDA margin decreased 80 basis points to 11.1%. The decrease in adjusted EBITDA margin was due to a reduction in gross margin, coupled with higher SG&A expenses.

Turning to our full-year performance on page 10. Net sales grew approximately 1% to \$6.7 billion for fiscal 2023. The increase was due to approximately 3 points of growth from acquisitions and higher average selling prices, partially offset by softer end market demand. We estimate that end market volumes were down low- to mid-single digits for the year, underpinned by a double-digit decline in residential lot development, a low- to mid-single-digit decline in nonresidential construction, partially offset by low-single-digit growth in municipal repair and replacement activity.

Our teams worked diligently to maintain the considerable market share gains we achieved during fiscal 2021 and 2022, when supply chains were disrupted and we maintained preferred access to products when product availability was low. Our markets were more competitive in 2023 than they were in 2022. However, the performance across our product and customer initiatives allowed us to maintain our market share even as supply chains and the competitive environment normalized.

Gross margin at 27.1% for fiscal 2023 was 10 basis points higher than last year, and it reflects the execution of our gross margin initiatives and benefits from acquisitions, partially offset by selling higher cost inventory compared with the prior year. Our local teams continue to execute very well to sustain margins by optimizing inventory levels, reacting with discipline to market prices, and driving our gross margin initiatives across our branch network.

SG&A expenses for fiscal 2023 increased by approximately 6% to \$931 million. The increase in SG&A was primarily due to investments in personnel to support growth, along with higher facility and distribution costs related to inflation and acquisitions.

Interest expense for fiscal 2023 was \$81 million, compared with \$66 million in the prior year. The increase was primarily due to higher interest rates on our variable rate debt and higher average borrowings under our ABL credit facility.

We recorded income tax expense of \$128 million for fiscal 2023, which was in line with the prior-year period. Our effective tax rates for fiscal 2023 and 2022 were 19.4% and 18.1%, respectively. The increase in the effective tax rate was related to higher allocation in net income to taxable entities following the exchanges of partnership interests in connection with the secondary offering and share repurchase transactions we completed.

We recorded \$531 million in net income for fiscal 2023, compared with \$581 million for fiscal 2022. The decrease in net income was due to lower operating income and higher interest expense.

Diluted earnings per share for fiscal 2023 was \$2.15 compared with \$2.13 in the prior-year period. Diluted earnings per share increased due to lower share counts following the repurchase transactions we completed during the year.

Adjusted EBITDA for fiscal 2023 decreased approximately 3% to \$910 million, and adjusted EBITDA margin decreased 50 basis points to 13.6%. The decrease in adjusted EBITDA margin was due to the impact of cost inflation on SG&A and investments to drive growth.

Turning to page 11, we delivered record operating cash flow for nearly \$1.1 billion for fiscal 2023, reflecting over 115% conversion from adjusted EBITDA. Our teams did a fantastic job optimizing inventory levels throughout the year even with higher product costs, inventory acquired through M&A, new inventory to support greenfields, and the growth of our product initiatives. On a year-over-year basis, net inventory was down about \$280 million or roughly 27%.

Net debt leverage at the end of the year was 2.1 times, and our available liquidity stands at more than \$800 million. Net debt leverage was higher than the prior-year period due to higher borrowings on our ABL credit facility to fund investments in organic growth, acquisitions, and share repurchases during the year.

Moving to capital deployment for the full year, we repurchased and retired 45 million shares valued at over \$1.3 billion at an average price of roughly \$30 per share. We did this while investing in organic growth and M&A, having deployed another \$780 million on 10 acquisitions during and after the year. We remain committed to our capital allocation priorities and have multiple paths for value creation through our ability to deploy capital and deliver high financial returns.

Subsequent to the end of the fiscal year, we entered into an incremental \$750 million term loan that matures in February of 2031 to expand our capital structure. The new term loan carries interest that term so far plus a margin of 225 basis points.

Concurrent with the issuance of the new term loan, we also entered into an interest rate swap with an all-in fixed rate of approximately 6.2%. The interest rate swap has a starting notional amount of \$750 million that increases to \$1.5 billion on July 27, 2026, through the instrument's maturity in 2028.

Before we head to Q&A, I'll cover our outlook for fiscal 2024 on page 12. As we look ahead to this year, we expect end market demand to mostly improve and contribute low-single-digit growth in 2024. We expect new residential construction, which represents about 20% of our sales, to grow in 2024 after coming off two weak years in 2022 and 2023. There is good momentum for new residential lot development with year-over-year growth in both single family permits and starts over the last several months, and we have experienced strong residential bidding activity to start the year.

Nonresidential construction, which represents about 38% of our sales, was soft in 2023, but we believe this end market will stabilize in 2024, as we benefit from our diverse mix of project types within this market.

Lastly, we expect municipal repair and replacement activity, which represents about 42% of our net sales, to steadily grow in fiscal 2024, bolstered by healthy municipal budgets, the critical need to repair and replace aged water infrastructure and, to a lesser extent, the potential for incremental funding associated with the Infrastructure Investment and Jobs Act.

In addition to our expectation of low-single-digit market growth, we expect to achieve 2 to 4 points of market outperformance from the execution of our product and customer initiatives, growth in under-penetrated geographies, the addition of key sales talent and local share gains.

We're also in a position to accelerate our pace of M&A activity. We have balance sheet flexibility supported by strong cash flows, a robust pipeline of opportunities, and a proven integration playbook. We expect 6 to 7 points of sales growth in fiscal 2024 from acquisitions that have already closed, with several more opportunities to follow like the acquisition of ACF West.

In total, we expect prices to be roughly flat for the year. Most of our sales include products that are highly specified at the local level. The cost of these products have historically been sticky, and we've been successful in passing along the rising costs through higher prices. Most of the pipe we distribute is municipal pipe products, which are specific to our sector with limited supply or alternatives, providing more price stability versus pipe products that can be utilized across multiple sectors. We will continue to monitor our municipal pipe products

closely, but we have been pleased to see the cost of these products remain relatively firm over the last several quarters.

As a reminder, fiscal 2024 includes a 53rd week, which will occur during the last period of the fourth quarter and add 1 to 2 points of net sales growth for the full year. We anticipate we could experience another 30 to 50 basis points of gross margin normalization from our fiscal 2023 fourth quarter results, as we release our remaining low-cost inventory. However, we will work to mitigate the impact of this through the execution of our margin initiatives as we progress throughout the year.

With these factors in mind, we expect net sales to range from \$7.4 billion to \$7.6 billion, reflecting year-over-year growth of 10% to 13%. We expect adjusted EBITDA to range from \$925 million to \$975 million, reflecting year-over-year-growth of 2% to 7%. We anticipate an effective tax rate in the 25% range now that most of our income will be allocated to taxable entities.

Regarding cash flow, we expect to convert between 60% to 70% of our adjusted EBITDA into operating cash flow in fiscal 2024, which we would expect to deploy to initiatives that will result in accelerated growth and value creation for shareholders.

I'll wrap up on page 13 to highlight our approach to capital allocation. We expect to generate significant cash flow in 2024 and beyond, given our margin profile and the working capital efficiency we have achieved. Our primary capital allocation priority is to invest in the growth of the business, both organically and through the execution of our M&A strategy. We expect to have excess capital after delivering on these objectives, which would allow us to consider future share repurchases and/or dividends to consistently return capital to shareholders over time.

In the near term, we expect to focus on integrating our recent acquisitions, continuing to evaluate our existing pipeline of deals and assessing our liquidity and leverage levels. As we progress throughout the year, we expect to provide additional details on our approach to returning capital to shareholders.

As I wrap up, I want to reiterate that we are confident in the targets we've laid out, and we look forward to helping our customers build more reliable infrastructure throughout 2024.

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

QUESTION AND ANSWER SECTION

Operator: Thank you, Mark. [Operator Instructions] Our first question comes from Matthew Bouley from Barclays. Your line is now open.

Matthew Bouley

Analyst, Barclays Capital, Inc.

Hi. Morning, everyone. Good morning, everyone.

Stephen O. LeClair

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

Hey, good morning, Matthew.

Matthew Bouley

Analyst, Barclays Capital, Inc.

Thank you for taking the questions. So, I want to pick up on the last points around where you are from a leverage perspective after all the success around M&A and share repurchase. Any quantification on sort of your pro forma leverage at this point? And then just sort of higher level, how do you think about this pace of M&A? You mentioned room to accelerate M&A and sort of timing of share repurchase, given where you are from a leverage perspective. Thank you.

Mark R. Witkowski

Chief Financial Officer, Core & Main, Inc.

Yeah. Thanks, Matthew, for the question. First, just from a leverage standpoint, as we talked about, target there is 2 to 3 times pro forma. With the recent acquisitions, we'll be certainly at the low end of that range. So, feel really good about where we're going to be, especially as we work through the year and get those acquisitions integrated. So, looking good there.

And I would say from – as we look at capital allocation, as we've talked about, the priorities are going to continue to be organic growth investments into that to grow organically. The M&A will continue to be a big priority for us. Our pipeline is looking really healthy there. So, we're going to assess those things. Obviously, we consider the valuation of the company. We still believe our value is undervalued compared to the peers that we've been outperforming. And we'll continue to assess that and provide some more details on that as we roll through 2024.

Matthew Bouley

Analyst, Barclays Capital, Inc.

Great. Okay. Thanks for that, Mark. And then, secondly, on the gross margin, the 30 to 50 basis points of additional normalization. I guess, could you describe sort of what is still in inventory that you would consider to be low-cost inventory that is – still has to, I guess, come out, so to speak. And then, I think the prior discussion of 100 to 150 basis points you had spoken that that included – or that did not include a lot of offsets you were making, organic initiatives and some M&A. So, when you talk about the 30 to 50 basis points, is that sort of net of additional offsets, or do you have room to kind of offset that further, so to speak? Thank you.

Mark R. Witkowski

Chief Financial Officer, Core & Main, Inc.

A

Yeah, thanks, Matthew. First, on the 30 to 50 basis points off the fourth quarter number, I would say that assumes we continue to benefit from some M&A, some of the private label efforts there. So, that 30 to 50 basis points does have some benefit that we would expect as we go through 2024. And I'll say there's still going to be opportunities that we can offset, hopefully, more of that. But that's really our expectation for kind of all-in throughout 2024.

As it relates to some of the low-cost inventory that still has to come out, we did expect, like I said, about 100 to 150 basis points to normalize. And we did experience a lot of that in 2023. I would say about 40 basis points of normalization did happen more of that later in the year. And it came from a lot of the higher-turn inventory items, and we're able to see those gross margins normalize. There are some items that we carry in inventory that are slower turns, take a little longer to work through the system. We saw a lot of that really start to normalize as we wrapped up 2023 and as we've gotten into the first part of 2024.

So, those slower-turn items now are kind of working their way out and expect that's kind of the headwind that we're seeing as we start 2024. But again, we're going to work to offset as much of that as we can with the initiatives that we've got, and we'll see how it progresses here into the first part of the year.

Matthew Bouley

Analyst, Barclays Capital, Inc.

Q

Thanks, Mark. Thanks, Steve. Good luck, guys.

Stephen O. LeClair

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

A

Thanks.

Mark R. Witkowski

Chief Financial Officer, Core & Main, Inc.

A

Thanks.

Operator: Our next question comes from Nigel Coe from Wolfe Research. Your line is now open.

Nigel Coe

Analyst, Wolfe Research LLC

Q

Thanks. Yeah, thanks. Good morning, everyone. So, I think, Mark, you said 3 points of contribution from M&A in the quarter, so 2 points from organic. Just want to confirm that's 2 points of volume, flat price. Please correct me if I'm wrong there. But then the outlook for flat price in...

Mark R. Witkowski

Chief Financial Officer, Core & Main, Inc.

A

That's right. That's right, Nigel, 2 points of volume, roughly, yeah.

Nigel Coe

Analyst, Wolfe Research LLC

Q

Great. And then the flat price assumption for 2024, you called out in the PR, you're seeing some deflation on the steel products and fire suppression. Please confirm that you're not seeing broad pressure in PVC, which obviously is where a lot of the attention is from investors. And then just given the move up in steel prices recently, does that mean that there's maybe a bit of upward pressure on some of those prices for the steel products?

Mark R. Witkowski

Chief Financial Officer, Core & Main, Inc.

A

Yeah. First, Nigel, I guess on steel, that is a more true, I'd say, commodity product that we distribute primarily in the fire protection space. And we've seen really pressure there throughout all of 2023, so we're going to start anniversarying some of that as we get into 2024. It's been relatively, I'd say, stable, although that does move, as we've talked about, can be more volatile. We did call out for the full year a neutral pricing environment. There are some – obviously, some puts and takes in there.

I would say as it relates to municipal PVC, as we've talked about, not as volatile as those true commodities like steel pipe. But that said, it has come off its peak levels, I would say. And that's embedded in our guide overall to be a neutral overall price environment, but really came off the peak. But really as expected, we did see a lot of supply chain normalize with municipal PVC, and you saw a lot of buying declines throughout 2023 from the distributor base. So, we think there was a lot of destocking that likely took place in the industry, and that really has normalized as we've exited 2023.

So, we've been pretty pleased with how that's held up. And now that we're really returned back to normal buying patterns, I think that's good evidence we could see some more stability there as we go forward as well.

Nigel Coe

Analyst, Wolfe Research LLC

Q

That's great. Thanks, Mark. And then my fourth question is really could we just size the Dana Kepner acquisition. I think 19 branches. I think that's your largest acquisition as a public company, so if you just size that. And then on your kind of EBITDA margin, the 80 basis points of midpoint down year-over-year, any of that would be attributed to M&A dilution?

Mark R. Witkowski

Chief Financial Officer, Core & Main, Inc.

A

Okay. Sure, Nigel. First on Dana Kepner, I'd say roughly those 19 branches, kind of that average branch size ends up being around a \$300 million top line for the full year. It'll end up being slightly accretive for us, I would say, at the bottom line. So, no real, I'd say, M&A dilution in the EBITDA figures for 2024. I would think of M&A as neutral to slightly accretive.

Nigel Coe

Analyst, Wolfe Research LLC

Q

Okay. Thanks, Mark.

Mark R. Witkowski

Chief Financial Officer, Core & Main, Inc.

A

Yeah. Thanks, Nigel.

Operator: Our next question comes from Dave Manthey from Baird.

David John Manthey

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

Q

Thank you. Good morning, everyone. My first question, and maybe I'm reading this wrong. But in your remarks, it sounded a bit like you're downplaying IJJA. And it's fine, I guess, relative to guidance if those dollars are incremental but I just – I'm wondering if we could just check your head here and make sure you're as optimistic today as you were a year ago, or has something changed.

Stephen O. LeClair

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

A

Hey, Dave, this is Steve. So, yeah, we really didn't put much into this year for that. We do view this as upside if it should start really rolling through. But as you've heard from us on the last several quarterly calls, we're seeing signs of this, but we're not seeing anything material really starting to move through, seeing some great opportunities that are really being sketched out right now for treatment plant operations in Arizona, out in Florida and a couple other areas. But it'll be a bit before those things actually result in orders and deliveries.

So, some work to do there. We're continuing to push that, doing everything we can to make sure our municipalities are aware of the available funding and into their state revolving funds. And we'll see kind of how that moves throughout the year, but not a whole lot put into the guide for 2024.

David John Manthey

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

Q

Okay. And second, excluding the benefit that you've gotten via acquisitions, how satisfied are you currently with the progress you're making towards your margin goals?

Mark R. Witkowski

Chief Financial Officer, Core & Main, Inc.

A

Yeah, Dave, I would say we're very satisfied as it relates to our margin initiatives, especially on the gross margin side, really made a lot of, I'd say, critical investments into private label during 2023. We added, as you heard, a lot of distribution space along with a lot of SKUs. And I think we're going to see some acceleration there in private label as we work through 2024.

Still scratching the surface on some of the pricing analytics but expect some really good movement there, and then really had some nice benefits come through in 2023 on some sourcing work the teams have been doing. So, really pleased there.

I'd say the area that we're watching closely is the SG&A side. We have seen some cost inflation come through in particular with a lot of our facilities and fleets that we lease. That's been under, I'd say, some more cost pressure. And then, we've continued to make investments in technology to make this business more modern and more efficient as we go forward. And then you heard we made some investments in some greenfields this year and some other investments for growth.

So obviously need those to pay off. That's part of our guide here as we go into 2024 and achieving and getting I'd say back to our consistent track record of delivering on above-market growth. I believe we made the right investments there, but obviously need that to pay off here in 2024.

David John Manthey

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

That all sounds good. Thank you.

Q

Mark R. Witkowski

Chief Financial Officer, Core & Main, Inc.

Thanks, Dave.

A

Operator: The next question comes from Mike Dahl from RBC Capital Markets.

Mike Dahl

Analyst, RBC Capital Markets LLC

Morning. Thanks for taking my questions. Piggyback off of some of the margin questions. Can you give us a sense, in terms of the cadence, how you're thinking about both gross margin and SG&A in kind of start the year in the first half versus the second half? And then I guess just as a point of clarification, I think you alluded to some of the M&A as still being gross margin accretive. So, just in totality, since you now have a couple of big acquisitions rolling through for the full-year guide, does that assume that the M&A contributions are coming in at or above company average gross margin? Thanks.

Q

Mark R. Witkowski

Chief Financial Officer, Core & Main, Inc.

Yeah, thanks, Mike. I would say on the gross margin side related to acquisitions, I'd say just slightly accretive there. I wouldn't expect really much in terms of significant benefit coming through there to offset any of that normalization.

A

In terms of the cadence, I would say most of that we expect to show up in the first quarter. First quarter will be, I'd say, our toughest comp. That was our best quarter as you look back to 2023. And really, I would say that the 30 to 50 basis points coming off the fourth quarter number on gross margin, I would look to that to be pretty steady throughout the year, but that first quarter comp will obviously show the toughest pressure from a year-over-year perspective.

Mike Dahl

Analyst, RBC Capital Markets LLC

Okay, got it. And then back on the SG&A dynamic, Mark, your comments. I think that's ultimately going to be an important lever for you guys. The guide seems to imply kind of flattish to maybe a little slight deleveraging, again, despite what should be a pretty strong top line, both organically and inorganically. So, specific to 2024, can you talk about the level of inflation that you're seeing or maybe parse out some of those other investments in terms of quantification to help us understand kind of, okay, what's it going to take in terms of rate of growth or timing to get back to a position where you're better leveraging SG&A?

Q

Mark R. Witkowski

Chief Financial Officer, Core & Main, Inc.

Yeah, thanks, Mike. In terms of what it's going to take, I will say most of our growth in 2024 is either tied to volume, and a big part of that being above-market growth and the M&A. I'd say the M&A has had a little higher SG&A base to it. And obviously, this is a heavy resource personnel business. So, when we're growing volume, it does take a little tougher time to leverage that, especially when we're seeing some of the cost inflation come

A

through, primarily with some of the leased facilities and vehicles that we use to deliver the product. So we need to see those start to ease a little bit, and that's going to allow us to leverage that a little better. Obviously, if we get a little bit more benefit from price on the top line, we can leverage that as well, but not really something we're expecting at this stage. So, if we see those investments we've made into growth pay off and get us more in the high end of that above-market range, I think you're going to start seeing the deleveraging start to happen again on SG&A.

Mike Dahl

Analyst, RBC Capital Markets LLC

Great. Okay. Thank you.

Mark R. Witkowski

Chief Financial Officer, Core & Main, Inc.

Yeah, thanks.

Operator: Our next question comes from Kathryn Thompson from Thompson Research Group.

Kathryn Ingram Thompson

Analyst, Thompson Research Group LLC

Hi. Thank you for taking my questions today. I'll just follow up on a clarification on guidance. With the M&A activity this year, we have a pretty good sense of the breakout, the product breakout contribution by your four major operating segments. But could you clarify which segments should see relatively higher growth, or should it be somewhat evenly split among the four groups?

Mark R. Witkowski

Chief Financial Officer, Core & Main, Inc.

Yeah, thanks, Kathryn. I would say as it relates to 2024, given the market growth, the above-market growth and the M&A that we've got built in, I would say your higher-growth categories are going to be pipe valves, fittings, storm drainage and smart meters, just given the acceleration we continue to see there. Fire protection, typically a higher-growth category for us, I would say, won't see as much of the benefit from M&A that's already closed. And they're primarily tied to non-resi for us, which we expect to be kind of flattish. So I would expect the other categories to be higher growth and probably a little softer on the fire protection side, given some of those dynamics.

Kathryn Ingram Thompson

Analyst, Thompson Research Group LLC

Yeah. And shifting gears to non-res, could you clarify, are there certain types of projects that are incrementally or tougher as you look into 2024, in other words, schools versus data centers versus warehousing? And then also a better understanding of the type of projects that you see or anticipate in 2024 and how that plays into your overall margin guidance.

Stephen O. LeClair

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

Yeah, Kathryn, this is Steve. So, I'll take you through a couple of areas that we're expecting some softness in non-residential, certainly light commercial retail. And as you know, we group multifamily into that. Those will continue to be depressed. I think we'll say the same thing with that warehousing as well.

On the strength side, the highway, street and bridge projects have been incredibly strong. Our position that we've got with storm drainage and with geosynthetics really should allow us to have some accelerated growth in those areas.

And then we see pockets and parts around the country where industrial manufacturing facilities are still going strong, really good opportunities for us, both with land development there and also with fire protection. Data centers continues to be a lot of buzz around that, so we're positioning ourselves pretty well to capitalize on those areas as well.

Kathryn Ingram Thompson

Analyst, Thompson Research Group LLC

Q

Okay, great. And then final question is around private label. One of your recent acquisitions, Eastern Supply, has custom fabrication abilities in addition to the normal pipe offerings. I appreciate the color you gave in the prepared commentary in terms of the bogeys of where you're seeking to grow private label, but could you pull the string a little bit more and help us understand the types of categories where you expect to see the greatest momentum and building out private label. And is there any type of geographic or project type that lends itself to greater private label? Thanks.

Stephen O. LeClair

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

A

Okay. Thanks, Kathryn. I wouldn't put Eastern Supply really into our private label piece as much. When we talk about private label, we're talking about a lot of categories that go into a lot of non-specified type products that go in.

Fire protection, we've really done a nice job there pulling products through there, whether they're lowly specified items like some minor valves, and certainly you get into things like hangers and struts and things along those lines that play really well for us to be able to distribute across our network.

In waterworks, we're still continuing to find opportunities there, whether it gets into packaging of glands and valve packages that we'll get into a lot of the nuts and bolts and accessory packs that go into that. So, there are just numerous areas for us to do that. As Mark shared with you, we've added 1,000 SKUs in, in this last year.

And I would say that if you look at kind of what our inventory plan was as we went into 2023 and bleeding off a lot of inventory, obviously, that impacted private label as well, too. So, we just weren't bringing in as much material in private label. And we feel now that we're much more stabilized in the inventory levels, our ability to pull through is going to be much stronger as we get into 2024.

Kathryn Ingram Thompson

Analyst, Thompson Research Group LLC

Q

Okay, great. Thanks very much.

Stephen O. LeClair

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

A

Thanks, Kathryn.

Operator: Our next question is from Anthony Pettinari from Citigroup.

Anthony James Pettinari

Analyst, Citigroup Global Markets, Inc.

Good morning.

Q

Mark R. Witkowski

Chief Financial Officer, Core & Main, Inc.

Good morning.

A

Anthony James Pettinari

Analyst, Citigroup Global Markets, Inc.

You talked about private label and – you talked about private label and sourcing and pricing analytics. I'm wondering if you could talk a little bit about some of the strategic customer initiatives you have around kind of the design build space and sort of what inning you are in terms of penetrating that. And is that an initiative where there's maybe some quantifiable benefit in 2024, or is that more kind of an investment to 2025 and beyond?

Q

Stephen O. LeClair

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

Yeah, sure, Anthony. We're fairly far along with that and we've had some really good results. You'll see that really put into our organic growth. Above market is where we've really bucketized that. The group that we have has been working with plant engineers and designers in this design build format. It's what I would call fairly new in terms of the application within water and wastewater treatment plants. And we are really on the cutting edge of this. And the use of the design build methodology is really starting to take shape and water and wastewater treatment plants design and we're really well-positioned for that. We have a number of folks that are certified and that actually sit on some of the boards that apply specifically into our industry and trade organizations. So, we'll continue to see benefit from that. You're going to continue to see major projects.

A

And one of the things we're going to start doing as we get into our subsequent year in our earnings calls is to start highlight some of the opportunities that we've been able to achieve there and how that plays out and get a little bit more visibility into that as we go forward this year.

Anthony James Pettinari

Analyst, Citigroup Global Markets, Inc.

Okay. That's very helpful. And then just following up on IIJA, some of the heavy construction materials companies, they kind of seem to talk about it as once we see volume start to hit, we could – we should see accelerating demand for three to five years as IIJA spending flows through. Understanding you're not baking much in from IIJA this year, is that similar to kind of how you think about it like once the spigot is turned on, you have a number of years of incremental demand, or do you expect something a little bit more start and stop? I'm just wondering how we should think about IIJA funding and the incremental impact to your volumes maybe over the next five years.

Q

Stephen O. LeClair

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

Yeah, I'm anticipating we'll see a minor acceleration this year as we get into it. We'll continue – we started seeing more of the funds starting to flow. We're seeing projects now starting to be scoped out as that starts landing and ultimately results in material being shipped and delivered. We're still encouraged by what we're anticipating could be incremental growth in the municipal piece over the next several years.

A

I would say we have a little different take on the long-term aspects of this. I don't believe this is going to be a one-and-done type thing, where you're going to see these funds utilized. As they're utilized, what we're really encouraged about is the long-term prospects of this. So, municipalities will borrow from the state revolving funds. They will pay back into that state revolving fund. And that money will be a regenerative source for many years to come, even beyond the initial issuance of the IJJA funds. And so, that's what has us really encouraged. That's what has our municipal customers encouraged as well to its ability, medium and long term, for what those funds can do.

Anthony James Pettinari

Analyst, Citigroup Global Markets, Inc.

Okay, that's very helpful. I'll turn it over.

Operator: Our next question comes from Joe Ritchie from Goldman Sachs.

Joe Ritchie

Analyst, Goldman Sachs & Co. LLC

Thanks. Good morning, everyone.

Stephen O. LeClair

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

Good morning, Joe.

Joe Ritchie

Analyst, Goldman Sachs & Co. LLC

Hey. So, maybe we can start on – yeah, maybe we can start on just the positive comments on resi lot development and ultimately what you're seeing in 1Q in terms of volume trends. Is it consistent with what the framework that you've laid out for the full year?

Mark R. Witkowski

Chief Financial Officer, Core & Main, Inc.

Yeah, Joe. As we ended 2023 and that fourth quarter, and really as we ended – started the back half of third quarter, we started seeing some positive signs of life in residential, particularly in lot development. Now, granted we're coming off from two years of down market in residential, so it was encouraging. But as we looked at the start of this year, the sentiment is really strong. I think people are getting acclimated into the higher interest rates at this point. And then, just the inevitable demand that's been out there for housing continues to be robust.

So, we're encouraged by what we're seeing there. We think that we're going to be anniversarying a lot of downside in residential for the last two years, and so we're encouraged by what we're seeing. Lots developments continuing to expand, and it seems to be more pervasive across the country than what we experienced before.

Joe Ritchie

Analyst, Goldman Sachs & Co. LLC

Yeah, that's great to hear. And, Steve, maybe just the comments around 1Q. The volume trend you're seeing across your business that seems like fairly consistent with what you're expecting for the full year at this point.

Stephen O. LeClair

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

A

Yeah. I'd say we've seen some really strong bidding activity and volumes to start the year. Now, say, if you go back to early part of 2023, we did experience a little bit of weather and a little softer start to 2023. So, relative to the comp, also strong but feel really good with how we're starting this year.

Joe Ritchie

Analyst, Goldman Sachs & Co. LLC

Q

Awesome. And then, Mark, just one quick follow-up for you. On the gross margin normalization, is it right to expect most of that to be first half weighted and to be through it then? I know you guys mentioned that some of it is a little bit longer cycle. Just how are you thinking about that from a cadence standpoint for the full year?

Mark R. Witkowski

Chief Financial Officer, Core & Main, Inc.

A

Yeah. I'd expect most of that to show up in the first quarter and kind of stabilize. And obviously, we'll be working to offset as much of that and build off of that as we get later into the year, but I'd expect it to be early.

Joe Ritchie

Analyst, Goldman Sachs & Co. LLC

Q

Okay, great. Thanks, guys.

Mark R. Witkowski

Chief Financial Officer, Core & Main, Inc.

A

All right. Thanks, Joe.

Operator: The next question comes from Patrick Baumann from JPMorgan.

Patrick Baumann

Analyst, JPMorgan Securities LLC

Q

Oh, hi. Good morning. Thanks for taking my questions. A lot's been covered already. Just had a couple cleanups here. On the Dana Kepner deal, just given its size, I'm just wondering if the multiple reflected a more competitive process. I'm asking in context of I think you said something about \$780 million deployed for the year and after the year ended. And it looks like in the fiscal 2023, the numbers were like \$231 million of spend, so most of that came after the year. So, curious if you have any comments on that.

And then related to that, on the business itself, what would be some reasons to pay a higher multiple for it? Are there synergies or something else to consider? And are there any kind of overlaps with your existing footprint, like any risk of cannibalization of existing sales?

Stephen O. LeClair

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

A

Yeah, Patrick, this is Steve. So, yeah, you would expect on a deal that size that certainly very incredibly well-respected regional player in our space that we are on the high end of the multiple as we went in. We do see great synergies associated with this. A lot of the product categories which we carry, which Dana Kepner did not, will have upside opportunity for us as well.

We really like the business for a number of reasons. It performs extremely well, great customer relationships, and the geographies are really strong fit for us, Arizona, Nevada, Colorado, all areas where we complement each other with our locations there with the customer profile, whether it's adding additional contractor customers or municipal customers. It's really a glove fit for us in all those areas.

It helps us strengthen our position in the Northeast as well, too, where we believe we're underpenetrated. So, for all those aspects, this was a really good fit for us. And we're really excited about the talent as well, too. They have a really strong team. We compete against them previously. We know them well. They have great sales talent, they have great management talent, and we're going to benefit from all that.

Patrick Baumann

Analyst, JPMorgan Securities LLC

Okay. So, there's not much overlap then in terms of the footprint cannibalization risk for sales?

Stephen O. LeClair

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

No, we really look at it as complementary at this point. A lot of those markets, there is a lot of fragmentation in those markets. There are lot of competitors in that space. So, we really view it as complementary to what we're doing.

Patrick Baumann

Analyst, JPMorgan Securities LLC

Helpful. And then the AC West (sic) [ACF West] deal that you mentioned I think earlier in the call, am I right to assume that that wasn't yet put in the guidance? Has it closed yet or no?

Mark R. Witkowski

Chief Financial Officer, Core & Main, Inc.

Patrick, we just signed that one recently. Expect a normal kind of sign to close. We've historically been right around 30 days or so. So, hopefully, we'll get that one here closed soon, and then that would be additive to the 2024 results.

Patrick Baumann

Analyst, JPMorgan Securities LLC

Thanks. And then just a couple of cleanups on the guide. So, on sales, the 1% to 2% from the extra week, that's embedded in the guide, right? And does that have any margin impact? And then there's like a lot moving around below the line given all the capital allocation toward the end of the year. You mentioned tax rate of 25%. Can you give us any sense on interest expense and share count for 2024 based on kind of where we're at today?

Mark R. Witkowski

Chief Financial Officer, Core & Main, Inc.

All right. Keep me honest. I'm going to try to catch all of those for you. The 53rd week, Patrick, is really no margin impact that is embedded in the guide. We expect that to be similar on the top and the bottom line.

In terms of the ins and outs, I would say from an interest expense standpoint, when you look at the expectations for debt and the rates, I'd say somewhere between 1.35 % and 1.45% for the full year.

And then as you're looking at share counts fully diluted, I think we're right around 201 million shares, so those should be fully outstanding then for each of the quarters as we go forward so you should be able to use shares in that range. Obviously, if we end up repurchasing any, it could have some changes there. But those will be things we announce in due course.

Anything that I missed there, Pat?

Patrick Baumann

Analyst, JPMorgan Securities LLC

Great. Thanks. Thanks for – no, no, thanks for indulging me with all those details. Really appreciate it and best of luck.

Mark R. Witkowski

Chief Financial Officer, Core & Main, Inc.

All right. Thanks.

Operator: [Operator Instructions] The next question is from Jeffrey Stevenson from Loop Capital.

Jeffrey Patrick Stevenson

Analyst, Loop Capital Markets LLC

Hi and thanks for taking my question today and congrats on the nice results. I just had one. And, Steve, you highlighted share gains with strategic accounts in your opening remarks. Just wondered if you could provide any more color on the primary opportunities for further share gain opportunities with key accounts over the midterm, just given your diverse customer base?

Stephen O. LeClair

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

Yeah. We really look at the share gains, particularly with the contractors that are doing a lot of this work that are traveling across the country to work on treatment plant projects, particularly those of design build, whether it's a Garney Construction or Archer Western. All of them are looking for consistency in delivery and execution with a national focus, but then ultimately when it comes time for fulfillment at the local levels, being able to do that. And with our branch structure now well over 300 branches, our ability to serve and fulfill through all of those different locations has given us a real powerful competitive advantage in being able to continue to grow with those contractors as we do that.

So we're encouraged by what we're seeing there. There's a lot of treatment plant and wastewater treatment plant being sketched out over the next several years. The pipeline for these things can be three to five years in terms of timing for a lot of these projects. And a lot of the work that we've done over the last several years has certainly allowed us to continue to grow and the pipeline looks really strong for those projects going forward.

Jeffrey Patrick Stevenson

Analyst, Loop Capital Markets LLC

Great. Thank you.

Operator: We currently have no further questions, so I will hand back to Steve LeClair to conclude.

Stephen O. LeClair

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

Thank you all again for joining us today. It was a pleasure to have you on the call.

Fiscal 2023 was an outstanding year for Core & Main. We are well-positioned to build on our momentum. We have a strong outlook for fiscal 2024. We are confident that our strategy will drive ongoing value creation, as we continue to execute our growth strategies and deliver on our capital allocation priorities. We have more levers than ever for driving growth and profitability, the cash flow generation to capitalize on it, and the team to execute it.

Thank you for your interest in Core & Main. Operator, that concludes our call.

Operator: This concludes today's call. Thank you for joining. You may now disconnect your lines.

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