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ZEAL Network SE (TIMA.DE)

Q1 2024 Earnings Call

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MANAGEMENT DISCUSSION SECTION

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Good morning ladies and gentlemen and welcome to today's Earnings Call of the ZEAL Network SE following the publication of the First Quarter Figures of 2024. I'm delighted to welcome the CEO, Dr. Helmut Becker; as well as the CFO, Sebastian Bielski, who will speak in a moment and guide us through the presentation and the results. After the presentation, we will move over to our Q&A session in which you will be allowed to place your questions directly to the management. So let's jump straight into the presentation. Mr. Bielski, the stage is yours.

Sebastian Bielski

Chief Financial Officer, ZEAL Network SE

Good morning, everybody. Also from my side, welcome to our Q1 results. I hope you can all see the presentation, but if not, you can also access it through the Investor Relations section on our home page. The agenda for today is that Helmut will give us a short summary of Q1. I will then take over with the financial update. Helmut and I will give you an update on progress and reconfirm our guidance. And then Helmut will close out the session with key takeaways.

Over to you, Helmut.

Helmut Becker

Chief Executive Officer, ZEAL Network SE

Good morning, everybody. Q1 was a strong start to the year. We saw very good customer acquisition in Q1 in terms of both volumes and efficiency at the same time. We took advantage of the Eurojackpot peak jackpot situation that we had in January. When we take a closer look at our performance, marketing performance, we see

that we actually outperformed previous similar jackpot situations. We also saw much smaller but still solid and efficient acquisition numbers in the bad jackpot environments that we had in February and March.

In Q1, we saw accelerating year-on-year growth in billings and revenue. This was driven by our improved gross margin revenue growth at 35% outpaced billings growth at 22%. And last but not least, we submitted the squeezed out request to LOTTO24. Back to you, Sebastian.

Sebastian Bielski

Chief Financial Officer, ZEAL Network SE

Thanks very much, Helmut. As Helmut has already outlined, the jackpot situation was really, really good in the first quarter. We had four peak jackpots in Eurojackpot and that compares to no jackpots in the first quarter of 2023. As you all know, these high jackpots are especially important for us when it comes to the acquisition of new customers. In terms of the average jackpot situation, it was actually very comparable to the last year.

As Helmut has already said, we saw very strong revenue growth of 35% year-on-year. This was driven by two things. It was 28% revenue growth in our core lotteries business. And we also saw a contribution of €2.2 million in revenue from the games business, which was started in the second quarter of last year. In terms of the lotteries revenue growth of 28%, this was driven by a 22% growth in billings and also a really nice margin expansion, which I will explain in more detail a little bit later.

On the cost side, personnel costs increased by 22%. This was driven mainly by an 11% increase in the number of FTEs. So, we hired a number of new people, especially in our new businesses like games and social lotteries. But also due to higher holiday accruals and also salary increases. On the marketing side, we strongly invested into the acquisition of new customers. As you can see, marketing costs were up €6.4 million or 91% versus the same quarter of last year. We made very, very good use of the strong jackpot environment.

We had a really efficient CPL. It was actually down 10% compared to last year. And we increased the number of new customers by 124% compared to the last year. One thing to also think about when thinking about the rest of this year, is it was very, very good timing for us being able to acquire a lot of new customers in January because we will have 11 month remaining in 2024 where all of these people can come back hopefully and buy more and drive more revenue for us.

When looking at the direct operating costs, they were up 47%. Main drivers of that increase were a higher share of PayPal as a payment method, which is more expensive than direct debit, which is our main payment method. We had a large number of new customers who all needed to be onboarded and as part of the onboarding they need to be KYC identified that cost money. And we also had some costs for games, especially commissions for games developers. Lastly, the indirect operating expenses were up by 28%, mainly driven by increased costs for external service providers and also costs in relation to recruiting of new employees. As I had said, we actually hired 11% more people this year than last year.

EBITDA was up 1% to €9.4 million, even on the back of very strong investment into growth, be it as strong marketing investment, buying new customers, but also investing into our platform by hiring more people. One thing to also keep in mind is that we had a big win in the Traumhauslotterie, which is one of our social lotteries, which decreased revenue by 0.8 million. If you take that into account and look at a like for like comparison of EBITDA versus the last year, EBITDA would have been €10.2 million for this year and up by 9%.

One thing that you will also notice when looking at the P&L is that our tax result looks pretty weird in the first quarter. We actually have a large positive tax result. The reason for that is that we have initially recognized €50

million of tax loss carry forwards which were sitting in ZEAL Network SE following the announcement of the squeeze out request that we submitted to LOTTO24. Because following the successful implementation of the squeeze out, we intend to form a tax consolidated group between LOTTO24 and ZEAL, and that will allow us to actually use the tax loss carry forwards in ZEAL.

As I already outlined, customer acquisition was very, very good in the first quarter, it was down 10% in terms of the CPL compared to a year ago and it was in-line with the fourth quarter of last year. When looking at this chart, you can see again that we had two outlier quarters last year in Q2 and Q3. We had talked about that before, why they were so high during Q2. There was a temporary increase in competition, especially in search engine marketing. In Q3, there was the launch of our major advertising campaign for LOTTO24. But overall, we're super, super happy to see the CPL decreased so much and return back into line with what we have seen in the past.

As I already said, billings in lotteries increased by 22%. This was driven by a 21% increase in the monthly active users, up to 1.3 million monthly active users in Q1. And also an increase of 1% in the average billings per users, especially the monthly active user increase is something that we really like to see. It was driven by both an increase in the overall size of our customer base, but also a higher level of customer activity, which is something that we usually see in a high jackpot environment but it's also something that we have also seen in the last couple of quarters where the jackpot environment was not quite as good as in [ph] Q1 (00:08:37).

Helmut will now also give an update on the status of execution versus our strategic plans, which we had outlined in the last presentation.

Helmut Becker

Chief Executive Officer, ZEAL Network SE

Thanks, Sebastian. We now move on to page 12. Let's revisit a slide that we shared with you before. On this slide, we say what we do in 2024, and then we do what we say. So here's a few highlights of what we have done in the first quarter. We have significantly grown our margin and we will continue to do so. Our brand marketing proved successful. We can see this in the Q1 numbers, but we also see it in our brand marketing KPIs. We have received permission for 64 new games, but more importantly, eight of those are softer, lower return to player instant win games that we expect to work well with our customer base. And finally, the launch of a new charity lottery product is on track.

Back to you, Sebastian.

Sebastian Bielski

Chief Financial Officer, ZEAL Network SE

Thanks, Helmut. I will now go into a little bit more detail about some of the things that Helmut has already mentioned in terms of the major achievements that we saw in the first quarter. The most important one is the increase in the lottery billings margin to 13.3% on a like-for-like basis compared to last year, which means that we're excluding for this analysis the big win in Traumhauslotterie because we didn't have a similar big win in the first quarter of last year. You can then see that the improvement of 0.9 percentage points was driven by two things. 0.3% was driven by product mix. That means we were selling more high margin product. Like for example, the lottery clubs. And then 0.5% is the effect of the price optimization, which we have started to roll out. We will roll out more price optimization over the coming month, and we still expect to see a billings margin of more than 15% in the second half of this year.

In terms of customer acquisition, Q1 of 2024 was the second best quarter since we changed our business model back to lottery brokerage. You can see that only one quarter was better and that was Q2 in 2020. That quarter had five jackpots instead of four, so it was even better. And all of these five jackpots were in April 2020. And when you go back to this point in time, you may remember that that was the time of the first COVID lockdown in Germany. So many stationary lotto outlets were closed. A lot of our customers were stuck at home looking to spend time. And the fact that we were able to almost reach that level of customer acquisition, even though we had one less jackpot and we're now living in a post-COVID world, is a clear testament to the strength of our brand marketing that we started and also our overall customer acquisition efficiency.

A couple of highlights that I would like to mention for Q1 is that we were seeing a very high share of branded and organic traffic. That is on the back of the TV marketing, which we started in Q3. One thing to remember, branded and organic traffic is normally the highest quality type of traffic that we can see. Very good conversion metrics that we're seeing. Very good customer loyalty from these type of customers. Also, we saw strong efficiency gains in social media marketing. There were two things that we did. Number one, we in-sourced social media marketing. In the past, it was handled by an agency. Now, we're doing it in-house. And we also changed our bidding algorithm and we are seeing really, really good efficiency gains. And lastly, we also saw efficiency improvements in search engine marketing where we adjusted our bidding strategy a little bit.

As Helmut has already shared. We are pretty happy still with our games business. We're seeing good development of the KPIs, especially pay-ins and billings are continuing to improve quarter-to-quarter. A couple of things to also mention is overall, our number of games is still too small. We have about 85 games online at the moment, including a number of games which were recently approved by the regulator. We are able to take the number of games up to about 120 games over the coming month, and we're still in the process of submitting a lot of more games. So, we will see more and more games coming through in the course of this year and then also next year.

As Helmut has said, one thing that we're especially excited about is that for the very first time we're able to convince the regulator to approve eight instant win games. We think that these type of games have a much higher appeal for our core lottery customers and also they have lower RTPs. So the average RTP that we're seeing in the games business is about 88%. These new games have RTPs between 65% and 80%. So that also means that we will see a higher billings margin for the games business in the future under the assumption that our customers will actually like to play these games.

We also want to reconfirm our guidance for this year. So, we still see revenue of between €140 million and €150 million and EBITDA between €38 million and €42 million. This would mean a growth of between 21 and 29% compared to this year to last year for revenue and 16% to 28% growth in EBITDA compared to last year. We still expect an acceleration of revenue growth in the second half driven by especially the margin optimization measures. We will continue to invest into marketing like we have done in Q1. And we still expect to spend between €40 million and €45 million for our marketing in the [ph] brokerage business (00:15:19). We expect continued growth of our games business, especially now that we have the new type of instant win games and with good margin. And we still expect to launch our new charity lottery in the second half of this year. In terms of the midterm growth outlook, we still expect high-to-mid teens for the period between 2023 and 2026.

Now. Helmut will wrap up with a short summary.

Helmut Becker

Chief Executive Officer, ZEAL Network SE

Thanks, Sebastian. In summary, we had a strong start to 2024. Our customer acquisition is performing really well. We plan to further expand our investment into brand building and games is on track. Thank you very much. And we now move on to the questions and answers part.

QUESTION AND ANSWER SECTION

A

Thank you so much for your presentation and congratulations on the results. I think I should get myself a lot of loads and hope to receive as good numbers as you guys have. So we will now move over to our Q&A session. For a dynamic conversation, we kindly ask you to ask your questions in person by audio line. To do so, please click on the virtual raise your hand button. And if you have dialed in by phone, you can use the key combination star key nine to enter the queue, followed by pressing star key six to mute yourself. And if you are not able to speak freely today, you can also place your questions in our chat box.

And we already received the first virtual hand by Henry, so please go ahead and unmute yourself.

Henry Wendisch

Analyst, NuWays AG

Q

Yeah. Hi, everybody. I hope you can hear me fine. A couple of questions from my side. Let's start with the P&L. I saw that indirect costs were slightly below my assumptions. I was expecting ramp-up costs for the new social lottery already and probably this would be slightly postponed. Does it mean that the launch is as planned for H2, obviously, but also will the investments come into effect on the P&L also in H2 or would you expect in Q2 already some ramp-up costs and then indirect costs, run rate to increase a little bit.

Sebastian Bielski

Chief Financial Officer, ZEAL Network SE

A

Yeah. So we expect to see some cost in this in the second quarter, but it will be back end loaded to the third and fourth quarter in terms of the ramp-up costs for the new social lottery.

Henry Wendisch

Analyst, NuWays AG

Q

Okay. Thank you. Second question, in the last reports, you gave a specific EBITDA contribution from games business and I haven't found it in the report yet. Will you disclose the number for us, please?

Helmut Becker

Chief Executive Officer, ZEAL Network SE

A

We will not do that for the time being.

Henry Wendisch

Analyst, NuWays AG

Q

Okay, that's a bummer. But it's fine. Yeah, we talked about marketing a lot and I've seen that you increased marketing efficiency to quite some level. So congrats on this side. But I would assume that also during high jackpot levels with other the state lottery is also pushing marketing on Meta and Alphabet that the cost per click

might actually increase. Did you observe this? And despite the cost per click increase that I assume right now you still managed to decrease CPL so maybe put that more into perspective for me to understand it better.

Sebastian Bielski

Chief Financial Officer, ZEAL Network SE

A

I think there is two factors at work here. So, generally speaking, cost per click tends to increase over time in almost all marketing channels. So, this is just a given. But you need to also take into effect the conversion. So, two effects, the cost per click is generally speaking going up. You can decrease cost per click by changing your marketing strategies a little bit. So, I think this is to some degree what happened in social media marketing where we were actually more efficient even on kind of like the very high level.

But then secondly, what we saw in the first quarter is also conversion rate improvement. So, between a click and a lead and between a lead and then a customer, actually playing there's a number of conversion steps. And what we saw is that these conversion steps actually improved in terms of the conversion rate. I think it was driven by two things. Number one is the very high share of organic and direct traffic, which always has a very good conversion. And then secondly, it's also driven by certain changes that we made to [ph] adjust panel (00:20:43) customers through more efficiently in the signup process.

Henry Wendisch

Analyst, NuWays AG

Q

All right. Got it. Thank you. Two follow-up questions on operating cash flow and financing cash flow. Operating cash flow turned negative this quarter. I didn't expect this is mainly because of working capital changes and the other financial liabilities. Does that have to do with the weird tax result that you mentioned before or what's the driver behind this?

Sebastian Bielski

Chief Financial Officer, ZEAL Network SE

A

No, it doesn't have to do anything with the tax result that I mentioned. So the tax result is purely on the P&L level at the moment. This will be cash flow relevant over the coming years, so starting next year. In terms of the working capital changes that you noticed, these are just generally swings in working capital that we see quarter-by-quarter, to be honest. So there wasn't anything...

Henry Wendisch

Analyst, NuWays AG

Q

Okay. So, it might be swing back in next quarter and it might even [ph] order with (00:21:42) the course of the year.

Sebastian Bielski

Chief Financial Officer, ZEAL Network SE

A

Exactly, yeah.

Henry Wendisch

Analyst, NuWays AG

Q

Okay. Perfect. And financing, cash flow. I saw you talk €20 million loan. This is probably for the upcoming dividend or is it something to do with the squeeze out an indication on the squeeze out price that I'm assuming or guessing right now?

Sebastian Bielski

Chief Financial Officer, ZEAL Network SE

A

It has nothing to do with the squeeze out. So this was a loan that we took out from Commerzbank. We actually signed the loan documentation already last year. We drew down the loan at the beginning of this year in January. And this is just a normal part of how we finance the business.

Henry Wendisch

Analyst, NuWays AG

Q

Okay, thanks. That's been it. Thank you so much and congrats on the result, by the way, you were astonishing.

Sebastian Bielski

Chief Financial Officer, ZEAL Network SE

A

Thank you very much.

A

Thank you so much, Henry. So, we will now move over to the questions from [ph] Tim (00:22:30). So please go ahead.

Q

Yeah, good morning. Congrats also from my side. Thanks for taking the question. Looking at your guidance and I mean, fantastic Q1 and the April volumes in the lotteries were also quite good. I wouldn't say on the same level as January, but also quite good from my take. So, would you say it's fair to assume that the lower end of your guidance seems quite conservative, seeing that you will improve the margins in the second quarter even further?

Sebastian Bielski

Chief Financial Officer, ZEAL Network SE

A

I mean, look, we just reconfirmed the guidance, including the range. Given that we are a lottery business, we unfortunately also do not have a crystal ball. So we don't know how many more [ph] peak (00:23:22) jackpots we will see during the course of this year. And so we are confident to reach our guidance in terms of re-guiding towards lower and mid-range upper end. I think at this point in time we just stand a bit behind our guidance.

Q

Okay. Fair. But was April also quite good? Could you comment on that?

Sebastian Bielski

Chief Financial Officer, ZEAL Network SE

A

Yeah, I mean, so far we're super happy with April. Again, we saw a very efficient customer acquisition during the [ph] peak jackpot (00:23:51) that we had. Good revenue. EBITDA let's see, a little bit too early in the month for me to comment on that. But overall, the mood is very good.

Q

Perfect. Could we maybe jump into the EBIT? I mean, obviously you had – you used like in prior quarters, you used the jackpot environment to gain a lot of customers. And – but considering your marketing efficiency, how happy are you with profitability? Or is that all in line with your sort of investment strategy and then will pan out in the coming quarters or years?

Sebastian Bielski

Chief Financial Officer, ZEAL Network SE

A

We were actually very happy and we were, to be honest, positively surprised, especially with the result that we saw in January. The payback period that we saw from the customers that we acquired in January was very, very short. So, really, really high ROI customers that we acquired. And so we were actually positively surprised and it gave us a lot of confidence to continue with the marketing measures that we are implementing at the moment.

Q

Okay. And maybe one question on the competitive environment. I saw that Lottoland has now received a lottery brokerage license. Can you comment on that? Have you seen any changes, any marketing campaigns there? How is your feeling on that?

Sebastian Bielski

Chief Financial Officer, ZEAL Network SE

A

Yes, you're right. They received a license or a permission. We don't see any changes yet. We expect them to launch at some point in time a brokerage business, but we don't expect this to impact us in a major way.

Q

Okay. And then maybe, Sebastian, last question for you. If we're looking at – you mentioned the higher direct cost reasons in Q1. If we look at the rest of the year, should we look at a similar absolute level or relative level of the costs for direct costs in the coming quarters?

Sebastian Bielski

Chief Financial Officer, ZEAL Network SE

A

I mean, generally speaking, I would always look at a relative level. So, direct cost as a percentage of billings, for example, with the one caveat that we had, especially high customer identification cost in the first quarter because we had so many new customers coming in. But generally speaking, I would look at as a percentage of billings.

Q

And do you expect this sort of this PayPal direct debit share to continue? Or was that also – is that a sort of the current mood of the customer? Or was that more sort of a onetime effect or what's your assumption there?

Sebastian Bielski

Chief Financial Officer, ZEAL Network SE

A

My assumption is that it will continue. So this is not something that we're necessarily actively driving. It is a choice that we give customers to pick their payment method. PayPal is more expensive. The one good thing with PayPal is that to a certain degree, it also has a lower level of bad debts for us, right? So this is [indiscernible] (00:26:55) but net-net, it is more expensive.

Q

And is the conversion better? Because, I mean, payment methods also have a conversion implication. If I'm – from my experience, do you see there – is that also something which is maybe better on that respect?

Sebastian Bielski

Chief Financial Officer, ZEAL Network SE

A

It depends a little bit on the type of player, to be honest. So generally speaking, German players, especially lottery players, really like direct debit as their preferred form of payment. We do see that people in the game side of the business like to use PayPal.

Q

Okay, perfect. Thank you very much. All the best for the next weeks. Thanks.

Sebastian Bielski

Chief Financial Officer, ZEAL Network SE

A

Thank you.

A

Thank you, [ph] Tim (00:27:39). Let's now move forward with the questions from Marius.

Marius Fuhrberg

Analyst, Warburg Research GmbH

Q

Yeah, hi. Hope you can hear me. First question from my side will be, you mentioned higher staff costs as you hired more personnel. Is this run rate we should expect for the rest of the year as well? Or are you happy with your staff right now or do you plan to ramp up this further?

Sebastian Bielski

Chief Financial Officer, ZEAL Network SE

A

Yeah, we do expect this the ramp-up to continue. So, we are hiring for a number of positions at the moment. So, we do expect that the number of FTEs continues to increase over the course of this year.

Marius Fuhrberg

Analyst, Warburg Research GmbH

Q

Okay. And the run rate of Q1 should be a good estimate for the rest – remaining quarters as well.

Sebastian Bielski

Chief Financial Officer, ZEAL Network SE

A

Well, I mean, if you just take the run rate, I think it wouldn't necessarily be a good indicator if you assume that we increase the number of employees, right? So it should increase also over the course of this year.

Marius Fuhrberg

Analyst, Warburg Research GmbH

Q

All right. With regard to marketing, am I right to assume that in Q1 you had no brand awareness campaign but rather yeah, that's performance marketing and leverage the jackpot environment?

Sebastian Bielski

Chief Financial Officer, ZEAL Network SE

A

No, we actually also did a big brand campaign. So we had a big TV burst in January, especially. So there was quite a bit of brand investment in January. So in terms of our brand strategy, we have a bifurcated strategy. So, we have certain bursts that we do where we have a very high level of intensity. And then we also have a always-on type of strategy. So, it has kind of like two aspects and we actually had a big burst in January.

Marius Fuhrberg

Analyst, Warburg Research GmbH

Q

All right. And with regards to your good marketing success in Q1, especially after the brand awareness campaign last year, what do your stats tell you with regards to customer quality and customer behavior? Is there any difference compared to previously or is it simply speaking the same type of customer that you win more efficiently right now?

Sebastian Bielski

Chief Financial Officer, ZEAL Network SE

A

Well, when we benchmarked the cohort performance of our customers to the last time that we had a similar jackpot environment. So, an acquisition month with good jackpots followed by two poor month. The cohort that we acquired in January actually outperformed the cohort that we acquired in July 2022, which was a comparable month. So, we see a very good quality of customers at the moment.

Marius Fuhrberg

Analyst, Warburg Research GmbH

Q

Right. And last one from my side will be with regards to games. What is the overlap of customers that are active in games with lottery? I guess it's quite high. Or is it even like 100% that you only have games customers which were lottery customers before? And also in addition to that, do you still consider white labeling the games business to other providers or do you want to keep it exclusive?

Helmut Becker

Chief Executive Officer, ZEAL Network SE

A

So that depends. So, to your first question, how big is the overlap? That actually depends a lot on the types of games that we offer and this is why we talked about some of the new games, the softer games, lower RTP games today. So, with the games that were initially approved, the high RTP, RTP stands for return to player, games, the overlap is not that big and they are traditionally called slot games. And if you look at the population, around 5% of the population play these types of games and the lottery players are pretty good cross-section of the population. So you can build a good business with relatively few customers who play these games and like these games a lot.

And we do think that these new games, the softer games, have a significantly larger overlap with the needs of our customers, our mainstream customers. And that's why we think that launching these games gives us additional growth opportunity.

Marius Fuhrberg

Analyst, Warburg Research GmbH

Q

Perfect. And the one latter part...

Helmut Becker

Chief Executive Officer, ZEAL Network SE

A

And we [indiscernible] (00:32:34) white label our games in a major way, but we do actually provide our games to other games operators. Like, we also buy games and license games from other games operators. That's common practice, but we also build our own games that are targeted to our user base.

Marius Fuhrberg

Analyst, Warburg Research GmbH

Q

All right. Thank you very much.

Unverified Participant

Thank you for your questions, Marius. So, in the meantime, we have received no further questions. We, therefore, come to the end of today's earnings call. Thank you, everyone, for joining at this lively conversation. So, should further questions arise at a later time, please feel free to contact Frank Hoffmann from Investor Relations and a big thank you also to you Helmut and Sebastian for your presentation and for answering all those questions. From my side, I wish you all a lovely remaining week and hand over again to Helmut and Sebastian for some final remarks.

Sebastian Bielski

Chief Financial Officer, ZEAL Network SE

Well, thanks, everybody. Again, we're super happy with our Q1 results. We think this will be a very good and strong year for us overall. In case you have any more questions, we really welcome them. We welcome to dialogue with all of you guys. Helmut and I are also on some conferences in the coming weeks. So, we hope to see a lot of you in person.

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