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# Cronos Group, Inc. (CRON.CA)

Q3 2023 Earnings Call

### CORPORATE PARTICIPANTS

Shayne Laidlaw

**James Holm** 

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Chief Financial Officer, Cronos Group, Inc.

Michael Ryan Gorenstein

Chairman, President & Chief Executive Officer, Cronos Group, Inc.

### OTHER PARTICIPANTS

John Zamparo

Analyst, CIBC World Markets, Inc.

Vivien Azer

Analyst, TD Cowen

### MANAGEMENT DISCUSSION SECTION

**Operator**: Good morning. My name is Valerie and I'll be your conference operator today. I would like to welcome everyone to Cronos 2023 Third Quarter Earnings Conference Call. Today's call is being recorded. At this time, I'd like to turn the call over to Shayne Laidlaw, Investor Relations. Please go ahead.

### **Shayne Laidlaw**

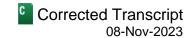
Head-Investor Relations, Cronos Group, Inc.

Thank you, Valerie, and thank you for joining us today to review Cronos' 2023 Third Quarter Financial and Business Performance. Today, I'm joined by our Chairman, President and CEO, Mike Gorenstein; and our CFO, James Holm.

Cronos issued a news release announcing our financial results this morning, which is filed on our EDGAR and SEDAR profiles. This information, as well as the prepared remarks, will also be posted on our website under Investor Relations.

Before I turn the call over to Mike, let me remind you that we may make forward-looking statements and refer to non-GAAP financial measures during this call. These forward-looking statements are based on management's current expectations and assumptions that are subject to risks and uncertainties that could cause actual results to differ materially from those projected in the forward-looking statements. Factors that could cause actual results to differ materially from expectations are detailed in our earnings materials and our SEC filings that are available on our website, by which any forward-looking statements made during this call are qualified in their entirety. Information about non-GAAP financial measures, including reconciliations to US GAAP, can also be found in the earnings materials that are available on our website.

Q3 2023 Earnings Call



Lastly, we will be making statements regarding market share information throughout this conference call. And unless otherwise stated, all market share data is provided by Hifyre. We will now make prepared remarks and then we will move into a question-and-answer session.

With that, I'll pass it over to Cronos's Chairman, President and CEO, Mike Gorenstein.

### Michael Ryan Gorenstein

Chairman, President & Chief Executive Officer, Cronos Group, Inc.

Thank you, Shayne, and good morning, everyone. I want to start by addressing the horrifying and despicable terrorist attacks in Israel in early October. Our thoughts remain with all victims, their loved ones and all Israelis, as they fight to be free from terror today and in the future. Cronos continues to prioritize the safety of our Israeli team and their families, and we will do everything we can to support them and our patients during this time. While our hearts are with our Israeli team, we have not lost focus on growing in existing markets where appropriate and opening new international markets such as Germany and Australia. James will go into more detail on the financial results during his remarks, but I want to comment on the wins this quarter.

We grew revenue by 22% year-over-year and 30% sequentially to \$24.8 million, propelled by 40% year-over-year growth in Canada, driven by strength in pre-rolls, flower and edibles. Adjusting our gross margin for an inventory write-down associated with transitioning out of our Winnipeg facility, the gross margin would have been approximately 19% in the guarter, a strong 260-basis-point sequential improvement.

We continue to have an industry-leading balance sheet with a cash and short-term investment balance of approximately \$840 million. The strength of our balance sheet is supported by improved gross margin, lower operating expenses, robust interest income and improved working capital management. We intend to build on this momentum for the remainder of the year and into 2024 as we realize P&L efficiencies and additional interest income from our cash and short-term investments.

In September, we sent our first order of cannabis to our German distribution partner, Cansativa, and we are very excited to bring the PEACE NATURALS brand back to the German market. Cansativa is one of the leading distributors of medical cannabis in Germany and has a network of approximately 2,000 high-volume cannabis-focused pharmacies that currently supply around 300,000 patients.

Re-entering the German market, which has about 83 million people, is a significant milestone for us. We are working closely with the Cansativa sales team who are excited about selling this brand in German market. Traction in the early innings of our launch is strong and Cansativa has already received significant orders with PEACE NATURALS. Our goal is to continue to expand our reach and brand awareness in Germany with the help of Cansativa to establish our PEACE NATURALS brand as a top medical brand, similar to the brand's reputation in other international markets.

Re-establishing Cronos and our PEACE NATURALS brand in German market will position us to capitalize on this growing opportunity, with additional upside potential from future legislative changes, including in the event the German government reschedules cannabis and no longer labels cannabis as a narcotic.

Turning to Australia, we are in the process of filing our first order to Vitura, with the first shipment to Australia planned to go out later this month. As a reminder, Cronos owns approximately 10% of the common shares of Vitura. In addition to forming a commercial relationship with Vitura, we also received a cash dividend of approximately \$346,000 in Q3, making this the second dividend received from Vitura.

Q3 2023 Earnings Call



Vitura is the market-leading prescriber for patient, pharmacy and supplier online platform, focused on creating medicinal cannabis products and digital health solutions that connect and strengthen the cannabis ecosystem in the Australian medical cannabis market. The Australian market has seen medical cannabis patient approvals through the authorized prescriber pathway, increased by over 120% year-over-year to approximately 300,000 approvals as of the first half of 2023, according to the Australian Government's Department of Health. Expanding in this market is a top priority for Cronos and we look forward to providing our partners at Vitura with high-quality cannabis products.

Turning to Canada, during the third quarter, we continued to execute our plan to create a robust offering of borderless products, highlighted by new launches and strong market performance. As of October, Spinach was the number one brand in the edible and flower categories, number three in vapes, and the number three ranked cannabis brand overall in Canada. These edibles accounted for 17.9% of the market's retail sales in Q3, remaining the market leader in edibles. We have an incredible product that continues to launch a new flavor profile and cannabinoid blends, the perfect example of a borderless, scalable product.

In the third quarter, our newest SOURZ by Spinach flavor, Pink Lemonade, became the ninth most popular edible in Canada. In total, we have five edible products in the top 15.

In dried flower, we continue to see strong performance. Spinach was the number two brand in dried flower in Q3 with 5.8% market share, and we have three products in the top 15 bestselling SKUs led by our GMO Cookies genetics across various pack sizes. We carried the Q3 strength in October and we're very excited to say that Spinach rose to be the number one flower brand in Canada. This achievement is the culmination of years of genetic breeding and best-in-class cultivation that separate our products from the field.

In the vape category, we held a 4.7% market share in Q3, climbing to number six. Looking at the monthly breakdown, Spinach rose to be the number five vape brand in September and even more impressively grew to be number three in October. We've done a lot of work on our vape portfolio over the last year and it's great to finally see these strong results in the market. Our 1-gram Blueberry Dynamite and our new 1.2-gram format, which have been flying off the shelf, have helped us gain share in the vape category. We will build on this momentum in the remainder of 2023 and into 2024, with the continued push to include flavor forward profiles and rare cannabinoids in our base.

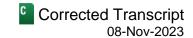
This year, we launched several new offerings to bolster the Spinach pre-roll portfolio, including Sonic Lemon Fuel, three pack pre-rolls and three new infused pre-roll offerings, Pink Lemonade, Peach Punch and Strawberry Slurricane.

In Q3, Spinach rose to be the number seven market share ranked pre-roll brand, a significant improvement from our 2022 position, powered by our number one ranked flower as a base to our pre-rolls. We can grow in this category and our pre-rolls are already receiving additional attention from consumers and industry.

In October, our Spinach brand won Best Pre-roll at the Grow Up Awards for our Spinach Fully Charged Atomic GMO infused pre-rolls. The Grow up Awards celebrates excellence in the cannabis industry, recognizing outstanding achievements in innovation in various cannabis-related categories. We are incredibly proud to be recognized by the Grow up Awards in this category.

Winning with our pre-rolls is particularly important for us as we overhauled our portfolio earlier this year to ensure our offerings enhance and elevate the consumer experience. We continue to invest our resources and expertise

Q3 2023 Earnings Call



in expanding our innovation pipeline and look forward to bringing new, high-quality pre-rolls to market in the coming year.

In October, we launched our much anticipated THCV-focused product in the vape and gummy categories. The Spinach FEELZ, Full Tilt, THC and THCV vape and gummies are designed to provide a boosted and elevated high. We plan to launch a THCV-infused pre-roll later in Q4, adding an additional offering under our robust pre-roll portfolio. We're incredibly excited about the possibility with THCV. We put a lot of work into these proprietary formulations that offer a unique and differentiated experience we know consumers have been eager to try.

Spinach FEELZ is a rare cannabinoid infused product that helps Cronos bolster a gummy, vape, and pre-roll offerings under the Spinach brand umbrella. Spinach FEELZ is a leading brand in Canada, with a lineup featuring rare cannabinoids, CBN, CBG, CBC and now THCV, many of which are made using our proprietary fermentation methods.

Earlier this year, we mentioned our intentions to bring our award-winning cannabis brand, Lord Jones, to the Canadian adult-use market. In November, our first product under this brand launched and we're thrilled to bring the Lord Jones brand back to its roots, with bold and elevated THCV-focused product. The Lord Jones brand is inspired by the possibilities of cannabis and we plan to leverage this brand to explore creative and unexpected ways to bring cannabis to the world and shape the category's future. Lord Jones products have been artfully crafted with scientific precision to bring the purest products and boldest flavors that deliver an unparalleled cannabis experience. We can't wait for adult consumers to go above and beyond with us and try these new products.

The first product under the Lord Jones brand in Canada is Hash Fusions pre-rolls. The popularity of Hash products and premium pre-rolls is increasing amongst adult consumers. Hash is currently the most popular solventless infusion and is the second most popular infusion overall in the pre-roll category. These Hash Fusion pre-rolls will go beyond delivering an elevated true-to-plant consumption experience. These pre-rolls are crafted with an optimized ratio of premium high potency flower and complementary solventless ice water hash, which preserves the bud's natural terpenes, fitted with a reusable ceramic tip to help cool the smoke. This new product has been extensively researched and sensory tested to deliver a smoother experience featuring bold flavors.

Later this month, we will also launch a Lord Jones' live resin vape, which will feature sought after cultivars and deliver a flavorful full spectrum live resin high.

Our next highly anticipated edible that was researched and developed over multiple years, the Lord Jones Chocolate Fusions, will launch early in 2024. In sensory panel testing, these products received even more buzz in their category than our award-winning and number one ranked Spinach SOURZ gummies. These edibles will feature mouthwatering, multi-textured, artisanal chocolate and high-quality ingredients in three flavors; cookies and cream, dazzle berry pop and salted caramel crunch.

Turning to Cronos GrowCo, their performance and cultivation continued to be strong. GrowCo reported a preliminary unaudited revenue of approximately \$6.2 million from non-Cronos customers in the third quarter. Additionally, the credit facility that Cronos previously provided GrowCo currently has \$69.4 million outstanding following the principal repayment of \$1.1 million by GrowCo in Q3. In addition, GrowCo made a \$1.2 million interest payment in Q3.

The solid financial performance of GrowCo yielding equity pickup, interest payments and loan pay back to Cronos is a vital component of our overall financial picture.

In Israel, our team impressively achieved sequential growth in the third quarter, despite relatively stagnant patient growth and continued competitive pricing pressures. Despite the war and challenging situation, our team continued to execute end market, maintained distribution and launching new products. Still, a bigger priority in the near term is ensuring we do what we can for our Israeli employees, their families, and the broader Israel population.

Turning to the US market, we were pleased with report of HHS's recommendation to the DEA suggesting that cannabis be reclassified as a Schedule III drug under the Controlled Substances Act. Reclassification would signify a significant shift away from cannabis as current Schedule I drug status. Schedule III substances are recognized as offering potential therapeutic benefits and can be obtained with a prescription. Regardless of the specifics of how Federal regulation and commercialization of cannabis products evolve, rescheduling would be a massive step for US cannabis.

Now, three quarters in the year, we are well on our way to achieving our previously guided \$20 million to \$25 million cost savings in 2023. And we still anticipate saving an incremental \$10 million to \$15 million in 2024 as we fully realize the savings from our actions taken this year. This quarter's successes have resulted in significant top line growth and operating expense savings, culminating in a substantial improvement in cash flow from operations, which better positions us to assemble a portfolio of borderless products with strategic infrastructure and global partnerships. The combination of these efforts and industry-leading balance sheet sets us up well to execute in any market.

With that, I would like to pass it on to James to take you through our financials.

### **James Holm**

Chief Financial Officer, Cronos Group, Inc.

Thanks, Mike, and good morning, everyone. I will now review our third quarter 2023 results in relation to the prior-year period. The company reported consolidated net revenue in the third quarter of \$24.8 million, a 22% increase from the prior year and up 30% from the second quarter. Constant currency consolidated net revenue increased by 27% to \$26 million. The revenue increase was primarily driven by higher cannabis flower and extracts sales in Canada and the initiation of cannabis shipment to Germany, partially offset by lower cannabis flower sales in Israel due to competitive activity, relatively stagnant patient growth and political unrest.

Reported consolidated gross profit in the third quarter was \$4 million, equating to a 16% gross margin, representing a \$0.8 million improvement from the prior year. Adjusted for the \$0.7 million inventory write-down associated with the wind-down activities at Cronos fermentation, gross margin would have been approximately 19%. The increase was primarily driven due to higher cannabis flower extract sales in Canada, lower cannabis biomass costs and continued supply chain optimization. We have displayed solid sequential progression on the gross margin line this year from Q1 at 15% to Q2 at 16% and Q3 at 19% gross margin on an adjusted basis. With this, you can see encouraging signs of improvement and stability, and we intend to build up this momentum into 2024.

Consolidated adjusted EBITDA in the third quarter was negative \$15.2 million, representing a \$3.3 million improvement from the prior year. The improvement was primarily driven by a decline in general and administrative and research and development expenses and an improvement in gross profit. As previously mentioned, we increased our target earlier this year to reduce operating expenses by \$20 million to \$25 million in 2023, and anticipate capturing incremental \$10 million to \$15 million in full-year savings in 2024 following the significant cost savings initiatives we implemented in Q3.

Turning to the balance sheet, the company ended the quarter with approximately \$840 million in cash and short-term investments, which is down by about \$1 million from the second quarter. In addition to maximizing the return on our cash, we received an interest payment on our GrowCo senior secured loan of \$1.2 million and a principal repayment of \$1.1 million for total cash paid by GrowCo to Cronos of \$2.3 million in Q3. Having the best balance sheet in the cannabis industry enables us to take calculated strategic bets while we remain steadfastly focused on reducing cash burn.

Moving to the cash flow statement, cash flow from operations was negative approximately \$180,000, representing a substantial improvement. We will continue to work to improve further as we create a fully self-sustaining operation. Free cash flow, defined as operating cash flow less CapEx, was only negative \$510,000. Another great achievement. We have many wins to point to. Market share gain, strong top line growth, steady gross margin improvement, OpEx reduction, cash balance optimization and improving cash flow from operations.

Looking back on those improvements, I share in Mike's confidence in the trajectory of the business and our preparedness for entry into new markets as they become available.

With that, I'll turn it back to Mike.

### Michael Ryan Gorenstein

Chairman, President & Chief Executive Officer, Cronos Group, Inc.

Thank you, James. Our brands are winning globally. Thanks to all the hard work from our employees to bring best-in-class borderless products to market. Our Spinach brand holds the top 10 market share position in Canada and all categories that participate in, which are flower, pre-rolls, vapes and edibles. We are confident that as regulations change, we'll be among the best positioned cannabis companies to capture additional market share in any market.

Before getting into questions, I want to level set what is under the Cronos umbrella and where things stand today. We close the quarter with approximately \$840 million in cash and short-term investments and zero debt. We generated over \$13 million in interest income in Q3 and we anticipate generating approximately \$15 million in interest income in Q4.

In Canada, our Spinach brand has the following market share ranked through October 2023. Overall, Spinach is the number three cannabis brand being number one in edibles, number one in flower, number three in vapes and number seven in pre-rolls. We brought the Lord Jones brand to the Canadian adult-use cannabis market with products we know can win. We have a leading medical brand, PEACE NATURALS in Israel, which posted \$5.7 million in net revenue in Q3.

This quarter, we shipped cannabis to Germany and intend to ship to Australia in November, extending our global reach. We have a 6.3% stake in PharmaCann, one of the largest private US MSOs currently on our books for \$49 million. We own 50% of the equity in Cronos' GrowCo, which is profitable, and GrowCo paid a \$2.3 million in principal and interest payments in Q3 on an outstanding loan balance of \$69.4 million.

We have an approximate 10% stake in Vitura, a leading medical cannabis company in Australia on our books for \$13 million. And finally, we have an exclusive partnership with Altria on a global basis.

At the close of the market yesterday, Cronos traded a market cap of approximately \$730 million, an enterprise value of approximately negative \$110 million. We have stabilized our cash balance and drastically improved our

cash flow trajectory, making us one of the best positioned cannabis companies to take advantage of new market growth opportunities.

With that, I'll open the line for questions.

### QUESTION AND ANSWER SECTION

**Operator**: Thank you. Ladies and gentlemen, [Operator Instructions] We do ask that you please limit yourself to one question and a follow-up. Thank you. One moment for our first question. Our first question comes from the line of John Zamparo of CIBC. Your line is open.

John Zamparo

Analyst, CIBC World Markets, Inc.

Thank you. Good morning. I wanted to start on Lord Jones. Exciting to see that that brand launch in Canada. I presume it'll be positioned as a premium product. So, I wonder in research you're doing, do you see more openness or willingness among consumers to shop within premium rather than just focusing on THC per dollar?

Michael Ryan Gorenstein

Chairman, President & Chief Executive Officer, Cronos Group, Inc.

Thanks, John. Yeah, that's a great question. When we look overall at the Canadian market, obviously, we see value is kind of the largest share of, it's a category we think is increasingly challenged, whereas premium, I think you have an opportunity to really carve out a niche. I think it's a segment that we can win in and I think it's more predictable to have durable margins. And when we're looking big picture at creating a borderless product portfolio, being able to win in that segment in Canada, where we do think there is room, that's going to translate into other markets a lot easier than something like a value brand would. So, very excited what we can do with the edibles and very differentiated. We're excited with what we can do with pre-rolls and vapes. And I think we're offering a much different proposition than just simply what's the potency per dollar.

John Zamparo

Analyst, CIBC World Markets, Inc.

Okay, that's helpful. Thanks. And then my second question more broadly on the market. When you look across the Canadian landscape, do you see any signs of more rational behavior in the sector? And do you get a sense that there's either a greater likelihood of participants exiting the market or greater likelihood of operators behaving more rationally when it comes to pricing?

Michael Ryan Gorenstein

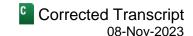
Chairman, President & Chief Executive Officer, Cronos Group, Inc.

Yeah, I don't think much has changed there. I will say I think that you are seeing a lot of exits. I don't know if that's necessarily because of decision-making from companies, maybe investors who just no longer are feeding losses and the bankruptcy processes playing out. But I do think that regardless of the reasons you are seeing exits, and I think that will lead to some rationalization. So, it's just making sure we get to the other side. And for us, focusing on the consumer is the way to do that, and I think the macro environment plays out.

John Zamparo

Analyst, CIBC World Markets, Inc.

Q3 2023 Earnings Call



Understood. All right. Thank you very much. I'll pass it on.

**Operator**: Thank you. One moment, please. Our next question comes from the line of Vivien Azer of TD Cowen. Your line is open.

Vivien Azer

Analyst, TD Cowen

Thank you. Good morning. So, I was hoping to just start with a housekeeping item, please. Can you just comment on the revenue benefit that you may have realized in the quarter from the sell-in on borderless products? Thanks.

James Holm

Chief Financial Officer, Cronos Group, Inc.

Hey, Valerie. So, this is James. Sorry, Vivien. There is minimal benefit from Lord Jones. You'll see that start to pick up in Q4 and beyond. So, we really anticipate that being a major driver into 2024.

Vivien Azer

Analyst, TD Cowen

Understood. Well, then all the more encouraging the growth that you guys saw in the Canadian marketplace, absent that. So, my follow-up question then would be, given the market share momentum that you guys are seeing across several key categories coupled with price deflation in flower, can we just revisit gross margin by product type? So specifically, if you could just dimensionalize how we should think about gross margin gaps or just rank ordering them between flower, pre-rolls, vapes and edibles? Thanks.

Michael Ryan Gorenstein

Chairman, President & Chief Executive Officer, Cronos Group, Inc.

Sure. So, yeah, our edibles, the number one edibles are still the highest margin products, right? And we are working to continually improve those. We do see I'll just mention the Lord Jones Choco Bite also being accretive to the overall company margin. Then that's followed by vapes, which we are again working on optimizing that portfolio. We just highlighted the 1.2-gram launches and are steadily taking share in that category. Then followed by pre-rolls [indiscernible] (00:25:11). And again, we're working to optimize that structure as we continue to assess supply chain and further optimize where there's opportunity. And then last but not least, flower. And again, still decent margins there, but that is our lowest current category, as you might expect with the current price competition. But all that said, right, our flower is outstanding, still continues to win versus competition and is improving in that category.

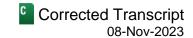
Vivien Azer

Analyst, TD Cowen

Perfect. Thank you.

**Operator:** Thank you. One moment, please. Again, ladies and gentlemen, [Operator Instructions] One moment for our next question. Our next question comes from the line of [indiscernible] (00:25:55) of Canaccord Genuity. Your line is open.

Q3 2023 Earnings Call



Hi there. Thank you. Good morning. This is [indiscernible] (00:26:01) on behalf of Matt Bottomley. So, I wanted to kind of really back to what John was saying in regards to the Canadian adult-use landscape. Last month, the country saw its five-year anniversary of its recreational legalization. And we've been seeing increased media reports of several license producers exiting the market, given the Canadian headwinds in the space. And so, I want to ask if you could provide your perspective on this. Have you been seeing decreased level of competition on the licensed producer level? And I guess trickling down to pricing, has this impacted your ability to price any of your products at higher prices?

#### Michael Ryan Gorenstein

Chairman, President & Chief Executive Officer, Cronos Group, Inc.

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Sure. Thanks. I think we have seen a number that are exiting. And I think if you look at the overall bankruptcies in Canada, certainly cannabis is toward the top of the list of how many bankruptcies there are. So, you are seeing some exits. But also, we've had a wave of new companies enter. They just were backlogged. So, it hasn't been something that's immediate and I think the reality is that you are going to continue to see more supply than demand in the short to medium term. But I think what happens is that really plays out in the value tier. So, you're seeing a lot of competition and a lot of irrational behavior when it comes to the big pack formats, the lower quality products. But you're seeing opportunity or at least we see opportunity still in mainstream and in premium to be able to continue to take share, to be able to grow. And while I don't know that you're seeing base opportunities to increase prices, I think that we are getting cost down. And as you innovate, I think that that's where you're able to have some pricing power.

So for us, the margin improvement, the market share growth, that's really driven by innovation, and innovation has really been king for us. So, I think we'll continue to see that going forward. And over time, I think you will see that rationalization. A lot of the companies are not going to be able to continue to stay, I think, in the market. I still expect they'll be a diverse group of companies able to participate. And as things eventually normalize, I think the overall market opportunity will drastically improve. But we've sort of learned, it doesn't make sense for us to just try to keep punting and waiting for that, we have to be able to do it now. And that's why it's been so important for us to focus on getting cost down, on growing and improving margins.

#### Vivien Azer

Analyst, TD Cowen

Got it. Thank you. And then just shifting gears to the international landscape side of things. We've been seeing more media reports indicating that there's been an increase in supply going into European market by these Canadian licensed producers. And so, I guess, has this affected your pricing ability with respect to exports that you've been providing to your European partners, including Cansativa this quarter? And if you could provide any additional commentary on what you're seeing in Australia as well with respect to the pricing of the exports going into that market. Thanks.

#### Michael Ryan Gorenstein

Chairman, President & Chief Executive Officer, Cronos Group, Inc.



Sure. So, I think when we compare it to Canada, certainly it's when you don't have excise tax factored in and you don't have the provincial distributors, you are looking at something that's margin-accretive overall. And while it's not like a few years ago where you only had one or two companies that were able to ship, I think it still is really about having a quality product. These markets, as more suppliers have popped up, also consumers have become more sophisticated and knowing what they're looking for. And I think that helps us. We like knowing that consumers are making choices based off the quality of product, because ultimately we think that is going to drive more momentum and more share for us. So, I think medical, you're almost always likely going to have a better

Q3 2023 Earnings Call



margin profile than in a more developed adult-use market. And we haven't really seen anything that reverses that trend. So whether it's Israel, Germany, Australia, we still see a lot of positives overall from flower.

**Operator**: Thank you. I'm showing no further questions at this time. Ladies and gentlemen, this does conclude today's conference. Thank you all for participating. You may now disconnect. Have a great day.

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