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YETI Holdings, Inc. (YETI)

Q2 2023 Earnings Call

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CORPORATE PARTICIPANTS

Tom Shaw
Vice President-Investor Relations, YETI Holdings, Inc.

Matthew J. Reintjes
President, Chief Executive Officer & Director, YETI Holdings, Inc.

Michael McMullen
Senior Vice President, Chief Financial Officer & Treasurer, YETI Holdings, Inc.

OTHER PARTICIPANTS

Randal J. Konik
Analyst, Jefferies LLC

Peter Sloan Benedict
Analyst, Robert W. Baird & Co., Inc.

Sharon Zackfia
Analyst, William Blair & Co. LLC

Joseph Altobello
Analyst, Raymond James & Associates, Inc.

Robert F. Ohmes
Analyst, BofA Securities, Inc.

Peter Grom
Analyst, UBS Securities LLC

John Kernan
Analyst, TD Cowen

Xian Siew
Analyst, BNP Paribas Exane

MANAGEMENT DISCUSSION SECTION

Tom Shaw
Vice President-Investor Relations, YETI Holdings, Inc.

Good morning, and thanks for joining us to discuss YETI Holdings' Second Quarter 2023 Results. In the call today will be Matt Reintjes, President and CEO; and Mike McMullen, CFO. Following our prepared remarks, we'll open the call for your questions.

Before we begin, we'd like to remind you that some of the statements that we make today on this call may be considered forward-looking. And such forward-looking statements are subject to various risks and uncertainties that could cause our actual results to differ materially from these statements. For more information, please refer to the risk factors detailed in our most recently filed Form 10-Q and the Form 8-K filed with the SEC today. We undertake no obligation to revise or update any forward-looking statements made today as a result of new information, future events or otherwise, except as required by law.

Unless otherwise stated, our financial measures disclosed on the call will be on a non-GAAP basis. We use non-GAAP measures as we believe they more accurately represent the true operational performance and underlying results of our business. Reconciliations of these non-GAAP measures to the most directly comparable GAAP measures are included in the press release or in the presentation posted this morning to our Investor Relations section of our website at yeti.com.

And now, I'd like to turn the call over to Matt.

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Matthew J. Reintjes

President, Chief Executive Officer & Director, YETI Holdings, Inc.

Thanks, Tom, and good morning, everyone. YETI remains on pace in 2023 with sales moving to the higher end of our prior range, strong gross margin expansion, and a raise to our adjusted operating margin and full year EPS.

Before diving into the results and our strategic priorities, I would like to start with what we are seeing across our diverse channels in this increasingly dynamic environment. Starting with soft coolers and gear bags that have been out of the market for the majority of 2023, we remain on track to reintroduce the M20 backpack, the M30 tote and our SideKick Dry gear bag in the fourth quarter. We will also launch smaller sizes for each style of soft cooler in the fourth quarter and extend the sizes of the dry bag line in early 2024. Again, I would like to thank our YETI employees, partners and customers for their tremendous focus and execution throughout this effort to get these products back to market.

Regarding overall consumer demand, we continue to see a range of performance across our wholesale and DTC channels. There remains a focus on Drinkware with strong trends around hydration, color and new style. We're seeing this play out within our own portfolio and across specific consumer demographic. Customers are increasingly gravitating towards many newer formats of our bottled straw lid tumblers and our new colored match bottles. As we continue to grow and diversify our Drinkware category, we have expanded our products to include new size and customization offerings across a range of Yonder water bottles and we're pleased with the highly successful introduction of our Rambler beverage bucket.

In hard coolers, we saw strength this past quarter, particularly with our expanded line of wheeled coolers. Offering mobile options will continue to unlock opportunities across customers and geographies and we're excited about the innovation pipeline of both soft and hard coolers. YETI is well-positioned to win across our product categories and we're focused on our product development and marketing to take advantage of the trends we view as long-term.

Looking at our second quarter non-GAAP performance, adjusted sales grew 2% for the quarter. Results included a 9-point drag from the absence of certain soft coolers, offset by solid growth within the rest of the portfolio. This is comping against a very strong year ago period, particularly in wholesale and corporate sales. As indicated, we remain well-positioned to deliver on our full year sales target. Our Drinkware business grew 8%, led by strong demand in our DTC channel and great reception to our product innovation. Demand for hard coolers and cargo helped offset some of the impact of the soft coolers as a category declined just 6% coolers as the category declined just 6% for the quarter. By channel, DTC sales grew 4%, led by Amazon and e-commerce, balancing a bit softer corporate sales, which faced the toughest quarterly compare from the year ago period. Wholesale performance came in better than plan supported by positive sell-through excluding the soft cooler impact as well as the initial shipments of specific fall product. We made a decision to move our Fall Limited Edition launch to early Q3 sensing we had a winner ready to go. As you have seen with the reception to our lilac and camp green colorways, this product was well set up to take advantage of the demand trends we were seeing.

Our supply chain team did an excellent job of having product ready earlier than anticipated; and our wholesale partners were supportive of the opportunity to take advantage of what we believe will be strong offerings. These products officially launched on July 20th. As a reminder, in the year ago period, our full commercial launch of second half colors happened in late Q2 versus in July this year.

Gross margin continues to be a highlight with adjusted gross margins gaining 270 basis points to approach 55%. We are delivering against what we said, as it relates to gross margin expansion. Importantly, we are now on pace to exceed our initial gross margin outlook for the year and we see momentum here into 2024. At the same time,

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as has been our pattern, we continue to invest across our business. We remain focused on the many growth opportunities ahead as we see the impact of product, brand and channel expansion. Finally, our balance sheet continues to be a source of strength for our business highlighted by cash exceeding $220 million. We also expanded our credit agreement to better align with our growth trajectory and to provide additional flexibility. Again, these results put us on pace to deliver at the higher end of our top line commitments for the year, while also driving bottom line upside.

Now, shifting deeper into our strategic growth priorities. As we broaden our consumer base domestically and globally, we continue our balanced approach of deeply endemic connections across 15 communities of passion fueled pursuits. A great example of leveraging our heritage in outdoor activities is the evolution of from barbecue and live fire cooking enthusiasts to the growing influences in the broader world of culinary. Here are a couple of micro examples. We've recently added Genevieve Taylor and Gill Meller to our ambassador roster. Genevieve is the Founder of the Bristol Fire School and a well-respected culinary voice in the UK. Gail is a highly regarded outdoor chef, food show host and author. We partnered with both in uniquely YETI ways to highlight their approaches to culinary and cooking in the wild.

We have also built partnerships across several new YouTube channels. This includes a multi-faceted and integrated partnership during the second season of Eater's Vendors series. In addition, our ambassador Brad Leone recently launched two series, Local Legends and Makin' It!, focused on uncovering the human stories of the fascinating people and what they eat. This is highly consistent with our YETI brand storytelling. In conjunction with expanding audience reach, we are also seeing opportunity in additional seasonal buying moments. We've historically mentioned our moms, dads and grads on these Q2 calls, but we look to enhance additional purchase occasion. Finally, we recently published our third ESG report showcasing our progress, as well as the opportunities that remain ahead. The report highlights two new circularity programs; YETI RESCUES and Rambler Buy Back, both of which we are actively looking to expand.

We're also building our own distinct voice as it relates to the durability of our portfolio by highlighting our product and the inherent strength of our design. The launch of our Everyday Single-Use Campaign this month focuses on durability, a story that is natural to our brand and positions our products against single-use alternatives. You'll see this come to life across out-of-home placement, media platforms and as a centerpiece of several music festivals this summer, including last weekend's Lollapalooza in Chicago.

As we shift to product innovation, let me give you a little more insight into the trends we are seeing and how we continue to build upon YETI's legacy of innovation and long-term relevance. Beginning with Drinkware, we have meaningfully diversified our portfolio over the past 10 years. This not only includes form factors, colors and sizing, but also the broadening of use environments and use cases. We are seeing great reception to our bottle assortment with excellent early results of the color matched options available across a wider range of our bottles.

Our expansion into both smaller and larger size hydration has enhanced the breadth and reach of our product. We are prioritizing Drinkware products, including extended sizes of our successful travel mug launched in 2021 and its various straw lid sizes. Customization opportunities continue to extend the value of this category. Our Yonder water bottles are a good example here as we added new sizes, new lid solutions and most recently our first use of multicolor customization.

Beyond traditional Drinkware, we debuted our Rambler beverage bucket during the quarter, which performed incredibly well and led to renewed interest in another great YETI caliber product in our [indiscernible] (00:09:09). We see continued opportunity to introduce products that encompass both outdoor and everyday use, whether that be at home, around the campfire or in the backyard. We have more products coming that will further extend the

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use cases and environments, starting with the introduction of the YETI Cocktail Shaker, which delivers the incredible value proposition of being backwards compatible with a very large portion of the YETI Tumbler sold over the past decade.

Finally, we were excited to partner with one of the best cast iron masters in the business at Butter PET Industries to introduce a very limited run YETI 12-inch cast iron skillet. This premium cast iron pan was created in hand was created the smoother and lighter skillet without getting up performance or durability, resulting in perfectly balanced teeth for any cooking occasion. It was fun to see the incredible reaction to this product as it was the third highest social engagement for a YETI product released since 2015. We were also able to give a strong nod to our culinary community.

On the Coolers & Equipment side, adjusted sales declined 6% for the quarter as we lapped last year's full introduction of our M20 and M30 soft coolers, and the impact of those products not in the market this year. As mentioned, hard coolers performed well during the quarter with Roadie 48 and Roadie 60 wheeled coolers leading the way during the early summer buying season. Combined with the Tundra haul, our volume of wheeled coolers more than doubled from last year.

In soft coolers, our Hoffer Flip posted a strong growth ahead of our upcoming relaunch of the M20 and M30 in Q4. We also look forward to the introduction of our M12 backpack cooler and the M15 tote cooler; two new sizes in the lineup. Our SideKick Dry gear case will also return later in the fourth quarter with additional sizes planned for early 2024. Outside of coolers, we continue to see strong results for our expanded GoBox cargo line, which has also resulted in a nice uptick in our LoadOut Bucket. On bags, we continue our wholesale expansion strategy and are excited about the colorway extension in the second half of the year. In addition, our original fully submersible waterproof pangolin, which launched in 2017, continues to perform very well.

Now, turning to our omni-channel. DTC sales were up 4%, supported by continued growth in both new and returning customers. Amazon led the way in the quarter as the channel continues to have a wide reach and to capture a largely distinct DTC audience. Of note, we did see very effective results from our participation in Prime Day last month where we offered a range of products concentrated in older seasonal colors and end of life product as we continue a planned and effective transition of product to newer generations.

On yeti.com, our focus is on building the optimal brand and purchase experience. This includes showcasing YETI, simplifying the buying decision; and enhancing our customization process. We continue to leverage learnings from our digital commerce and analytics teams to create more personalized experiences and targeted marketing spend across different customer cohorts. From a practical perspective, this means we continue to provide a dynamic website that will best match product and content with the individual customer.

In our corporate sales business, sales were roughly flat up against a very strong last year. Even with this, our total customer count continued to grow. This remains an important channel for us, and we are confident in driving growth here given the product interest, strengthening backlog, and untapped international opportunities. YETI retail continues to be a strong awareness and customer acquisition vehicle, driving the highest rate of new customers across our DTC channels. While we've seen strong customer acquisition and customer count; we're seeing slightly smaller baskets due primarily to the soft cooler products and change in units per transaction, which we attribute to some retail consumer conservatism.

Our retail stores remain a very important part of the awareness, consideration and purchase; both in-store and throughout our DTC and wholesale channels. This is supported by results from our market-based analytics across

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the 14 existing markets with YETI stores. During the third quarter, we'll open our 15th and 16th stores in San Jose, California; and just outside of Minneapolis in a Edina, Minnesota.

On the wholesale side, sell-through was positive; excluding the impact of the recall. Results also included the previously mentioned earlier than planned shipment to support the commercial launch of our Lilac and Camp Green colorway. This contributed to the better than planned sales performance for channel; so, we expect to keep combined Q2 and Q3 results in line with prior expectations.

International sales grew nearly 20% for the quarter to reach 13.4% of sales; up from 11.5% in last year's Q2. While growth in Australia and Europe remained robust, we did see slower growth in Canada given many of the same demand trends facing the domestic business and the outsized impact of the soft coolers. As we have previously outlined, enhancing capabilities to support growth is an overarching theme across our international businesses this year. We made strong progress on the transition of three of our non-US distribution centers, with the Netherlands opening in June, Australia in the coming days, and the UK planned in the fourth quarter. Customization is another big opportunity that we will continue to build in our international regions. Australia and Europe both plan to have the added benefit of customization co-located in their three fields.

We've also started our investment in data analytics internationally, including marketing attribution work in Australia and Canada. Understanding our customers and driving enhanced effectiveness in our engagement remains significant initiatives in all global markets. On the front end of the business, we continue to invest in driving brand awareness in these markets and continue to actively add international partners and ambassadors; who now represent nearly a quarter of our global roster. We continue to support some of our newer global reach partnerships such as Oracle Red Bull Racing and the World Surf League, while also establishing new local relationships with the Rangers Football Club in Glasgow and the North Queensland Cowboys Rugby Club in Australia.

Finally, we continue to drive in-person engagement and relevance across a range of local events, including the massive Calgary stampede in Canada, the Seize the Day Women's Surf Festival in Australia, and several outdoor and culinary experiences across the UK and Europe from The Game Fair to Meatopia and the Big Grill Barbecue and Food Fest.

In summary, our second quarter performance highlights our consistent execution and ability to adapt. While there remain unknowns in the market, we continue to deliver on the basics, building a brand, making great products, driving demand, growing our profitability and scaling internationally. This is supported by an increasingly agile team that is adjusting to meet the needs of the consumer, while always maintaining focus on what makes the YETI a YETI.

I'll now turn the call over to Mike to discuss our financials and outlook in more detail.

Michael McMullen

Senior Vice President, Chief Financial Officer & Treasurer, YETI Holdings, Inc.

Thanks, Matt. To start, I would like to provide a summary of the adjustment and charges associated with the voluntary product recall that are included in our GAAP results. I'll then focus on our adjusted non-GAAP performance, which we believe, provides a better picture of our underlying performance for the period. Finally, I'll discuss our updated outlook; including the increase to our full year adjusted EPS target.

Regarding the recall, our initial expense reserve taken in the fourth quarter was based on certain redemption assumptions, including the rate of redemption and type of remedy chosen. We began processing returns and

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claims from customers during the second quarter, which has informed several adjustments to our reserve. While the overall redemption rate has been on plan, there have been differences in redemption rates across the impacted products. In addition, of the remedy options we are offering our customers impacted by the recall, we have seen higher than expected gift card elections versus the product replacement remedy option. We have therefore made the following three adjustments to our recall reserve.

First, we increased the estimate for future gift card elections, resulting in a reduction to second quarter GAAP sales of $24.5 million.

Second, the update to our assumption of future gift card elections also resulted in a corresponding $5.1 million reduction in GAAP cost of goods sold, given the lower estimated cost of future product replacements.

And third, our recall-related logistics costs are now expected to be lower than our original assumptions, thus resulting in a $10.7 million benefit to GAAP SG&A expense. Overall, these three adjustments drove a net increase in the estimated recall expense reserve of $8.5 million this quarter. For more information on these reserve adjustments which are excluded from our non-GAAP results, please refer to our Q2 earnings press release and 10-Q filing.

Now, moving on to our adjusted non-GAAP metrics. Second quarter sales increased 2% to $427 million compared to $420 million in the prior year period. As we have previously outlined, we estimate that the stop sale of recalled products impacted our growth rate in Q2 by approximately 900 basis points. The quarter also had a $12.5 million benefit from gift card redemptions, related to remedies we are offering customers impacted by the product recall. While not specifically included in our prior outlook, we do believe that some of these redemptions replace what would have been existing demand and sales during the period. In particular, we saw redemptions across a wide range of products, including products with limited supply, such as seasonal colors and new product launches; thus removing an opportunity for us to fulfil an existing order in other channels.

Another dynamic that impacted our growth in the second quarter was related to the timing of wholesale shipments. To better support the strong color trend resonating in the market, we made the decision to accelerate the omni-channel launch of our newest seasonal colors, Cosmic Lilac and Camp Green, within Q3. This required us to start shipping these colors to the wholesale channel in Q2, which was earlier than what was assumed in our prior outlook. While modestly impacting the timing of sales between the second and third quarters, this dynamic has no impact on our full-year results.

As Matt mentioned, since their July launch, we have been very pleased with the performance of these new color offerings. From a channel perspective, direct-to-consumer sales grew 4% to $235 million, representing 55% of total sales, led by growth in our Amazon business. In the DTC channel, we saw strong performance in cargo, hard coolers and Drinkware; more than offsetting the impact of the recall on soft coolers. Wholesale sales decreased 1% to $193 million; with a decline in Coolers & Equipment partially offset by growth in Drinkware. The decline in coolers and equipment was driven again by the impact of the recall on soft coolers, partially offset by strong growth in hard coolers and cargo. From a point of sales perspective, we were pleased with our overall sell-through performance in Q2, which was positive after we exclude the impact of the product recall.

By category, Coolers & Equipment sales decreased 6% to $181 million, but did see strength in cargo and hard coolers. Our expanded line of GoBoxes continues to resonate as we expand distribution in the market. Hard coolers have been supported by ramping demand for the Roadie 48 and Roadie 60 wheeled coolers, as well as by solid growth in our core Tundra line. And within soft coolers, we continue to see good growth in our products that remain in the market, including the Hopper Flip line.

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Drinkware sales increased 8% to $233 million with growth in both the wholesale and DTC channels. We continue to see the strongest results when we highlight the breadth of our product portfolio, drive newness with color and extend the category into new areas. Our All-Day Drinkware campaign was very successful, highlighting our wide range of products in the category, while also driving engagement and conversion. Bottles remain a strong growth story for the brand supported by larger formats, new color matched straw caps and the addition of Yonder water bottles. Expanding on the strong demand for straw lid options in the category, we continue to see great results with our Rambler 25 ounce and 35 ounce mugs with straw lids. Finally, the launch of our new beverage bucket exceeded our expectations and supports our optimism as we look to extend the brand into new areas.

Internationally, sales grew 19% to $57 million; representing approximately 13% of total sales and led by strong growth in Europe and Australia. Gross profit increased 7% to $234 million or 54.9% of sales compared to 52.2% in the same period last year. The two primary benefits this quarter included 330 basis points from lower inbound freight and 130 basis points from lower product costs. These gains were partially offset by 40 basis points from higher depreciation and amortization related to investment and production capacity, 40 basis points from higher customization costs given the continued growth of our custom offering, 30 basis points from unfavorable foreign currency exchange rates, and 80 basis points from all other impacts. SG&A expenses for the quarter increased 15% to $167 million or 39.1% of sales, compared to 34.6% in the same period last year.

Non-variable expenses increased 390 basis points as a percent of sales driven by two items that had roughly an equal impact on our year-over-year de-leverage. First, incentive compensation costs for our employees. Note that Q2 will see the largest impact from incentive compensation during the year. And second, the impact of the stop sale on our top line growth, combined with our continued investments in areas such as head count, warehousing and demand creation to support our growth. Variable expenses increased 60 basis points as a percent of sales; primarily reflecting higher Amazon marketplace fees. Operating income decreased 9% to $67 million or 15.7% of sales, compared to 17.6% during the same period last year. Net income also decreased 9% to $50 million or $0.57 per diluted share compared to $0.63 in the prior year period.

Turning to our balance sheet. We ended the second quarter with $223 million in cash, compared to $92 million in the year ago period. Inventory decreased 34% to $322 million year-over-year. Inventory declined sequentially for the fourth straight quarter; down another $25 million for a cumulative reduction of over $168 million from our peak level in Q2 of 2022. Total debt, excluding unamortized deferred financial fees and finance leases was $84 million compared to $101 million at the end of last year's second quarter. We did not have a principal payment due in Q2 given we amended our credit facility during the quarter. This amendment included an increase of our revolver from $150 million to $300 million, as well as the refinancing of our existing term loan balance of $84 million with an extended maturity date to June of 2028.

Now turning to our updated fiscal 2023 outlook. We now expect full year sales to increase between 4% and 5% compared to fiscal 2022's adjusted net sales. The narrowing of our outlook reflects the second quarter impact of gift card redemptions, keeping the rest of the full year factors relatively unchanged. Given the unpredictability of future gift card redemptions, this outlook does not include the impact of any redemptions in the second half of the year. We do have some fluctuations of growth across quarters versus our last outlook. However, we continue to expect approximately flat sales growth over the first three quarters of the year in aggregate, followed by a return to double digit growth in the fourth quarter. This implies a low-single-digit decline in the third quarter compared to the prior assumption of approximately flat growth with the primary change coming from the updated timing of the shipment of seasonal colors into the wholesale channel.

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Second half sales include the following assumptions: We expect both product categories will see a sequential decline in year-over-year growth rates from Q2 to Q3 before returning to growth in Q4 as we bring our full soft cooler product lineup back to the market and continue to expand our Drinkware offerings. We expect wholesale to be down double digits in Q3 on top of a strong comp last year, and then return to growth in Q4. We expect DTC growth to strengthen as we move into Q3 and then to carry that strength into Q4. Also, we continue to expect DTC mix to reach approximately 60% for the year.

And finally, we expect an approximate 900-basis point total impact related to the stop sale in Q3. To reiterate, we remain bullish on our positioning for the fourth quarter where we expect to drive a lot of energy and newness across the product portfolio and see meaningful acceleration across both our primary product categories and sales channels.

Looking at margins, we are increasing our 2023 gross margin target to between 55.5% and 56%, up from 52.7% in fiscal 2022. The favorable impact of lower inbound freight costs continues to be the most significant driver of margin performance this year. In addition, we now expect a favorable impact from product costs for the full year. On the SG&A side, we expect full year SG&A dollar growth in the mid-to-high-teens. The factors that are driving our SG&A rate remain consistent. They include the impact of the stop sale on our top line growth, incentive compensation, variable expenses to support our DTC businesses and investments to support our future growth. From a timing perspective, we expect the SG&A dollar growth rate to be in the mid-to-high-teens for both the third and fourth quarters.

We are raising our operating margin range to 15.5% to 16% for the full year. While the third quarter margins are expected to be lower sequentially, we continue to expect over 20% operating margins in the fourth quarter due to both an expected return to double digit revenue growth and our strengthening gross margin profile. Including interest expense of approximately $4 million and an effective tax rate of 25.1%, we are raising our full year adjusted earnings per diluted share outlook to between $2.23 and $2.32 compared to $2.36 in fiscal 2022. As a reminder, this includes a $0.30 to $0.35 estimated impact from the stop sale of products included in the voluntary recall.

Looking at cadence, we expect that third quarter adjusted earnings per share will decline versus the prior year at a higher rate in Q3 versus what we saw in Q2 ahead of an expected return to strong earnings growth in the fourth quarter. On the cash side, we now expect a slightly higher level of free cash flow for the year in the $150 million to $200 million range driven by inventory improvements. This includes a $60 million outlook for capital expenditures, which is consistent with our previous outlook.

In summary, our Q2 top line results were above our expectations and we are on track to deliver our full year sales target. We continue to react to market trends and extend the brand smartly into new areas and we look forward to having our full product lineup available later this year with the return of the products impacted by the product recall. Gross margins continue to improve, supporting our ongoing investment across the business, but also improving bottom line profitability. Our balance sheet is stronger than ever driven by continually improving inventory levels and higher free cash flow, and coupled with the recent changes to our credit facility, we believe this will provide additional flexibility as we look to drive future shareholder value.

Now, I'd like to turn the call back over to the operator to take your questions.

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QUESTION AND ANSWER SECTION

Operator: Thank you very much. We will now begin the question-and-answer session. [Operator Instructions] We'll take the first question from the line of Randy Konik from Jefferies. Please go ahead.

Randal J. Konik
Analyst, Jefferies LLC

Q

Hey, everybody. I guess, Mike to start with you, given that we – look, you're coming out of a quarter where the market's clearly feeling like the numbers have bottomed and you gave good kind of granular guidance for the rest of the year. Can you kind of maybe reorient it or re-educate us on how we should be just thinking about the long-term kind of operating margin ability of this business, gross margins, that would be just like, just not specific numbers but just high level, how we should be kind of thinking about this business long-term? Thanks.

Michael McMullen
Senior Vice President, Chief Financial Officer & Treasurer, YETI Holdings, Inc.

A

Yeah. Hey, Randy. Thanks for the question. So here's what I'd say. If you go back to the last few years, we indicated that we gave up roughly around 600 basis points of gross margin rate due to inbound freight. This year, we've obviously raised our guidance and we said inbound freight is the majority of that impact. So, that would imply there's more to go next year as we get into 20204. I think without – I mean to your point, without giving specific guidance, I think what we're going to have to do is sort of weigh that against a need to invest both in products, in terms of materials, packaging, things like that; as well as back into our SG&A to help drive future growth. So, I think the only thing we've really said is that it is our intention to try to continue to drive operating margins higher over time and we think we've got the levers to do that specifically within gross margins.

Randal J. Konik
Analyst, Jefferies LLC

Q

Super helpful. And then my last question; maybe more for Matt. Maybe give us your perspective on where are we in the journey of taking an existing YETI customer like ourselves mostly on this call in building that breadth of product's story with those existing customers versus the continued acquisition of new customers; both domestically and abroad. Can you maybe give us some perspective on where we are in those different journeys and any kind of data that you guys look at to inform you and us on that where we are in those journeys, that would be super helpful as well. Thanks, guys.

Matthew J. Reintjes
President, Chief Executive Officer & Director, YETI Holdings, Inc.

A

Good morning, Randy, and thanks for that question. As we've talked about throughout this story, one of the things that's been consistent with how we built the brand and how we built out the product portfolio is that this idea of depth and breadth. That applies directly to the product consideration from consumers. And we've had great success in continuing to build a depth within our Drinkware business and depth in our cooler business, but also introducing new product and new consideration, things like chairs and bags and blankets and dog bowls. And you recently saw a fun deal we did with a limited run around this cast iron skillet. Just to continue to create opportunities for consumers to come back to the YETI brand and bring the same durability, performance and design to it.

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We feel like we're still in early days of that domestically, and obviously internationally, we're still building the brand and building out those initial moments of consideration. So we feel great about the umbrella that the brand gives us to expand product. We feel great about the portfolio we have today and the discovery that we're having within that. So, we look at geographic penetration; we look at households, we look at geographic penetration domestically across the regions, and we look at the retention rate we're getting with consumers, particularly from those high acquisition periods in 2020 and 2021. And as we said on the call, we feel great about the balance of acquisition of new customers we're getting and the retention we're getting.

Randal J. Konik
Analyst, Jefferies LLC

Q

Great. Helpful. Thanks, guys.

Operator: Thank you. We have our next question from Peter Benedict with Baird. Please go ahead.

Peter Sloan Benedict
Analyst, Robert W. Baird & Co., Inc.

Q

Oh hey guys. Thank you for taking this question. I guess just on the SG&A, maybe back to you, Mike. The growth mid-to-high-teens. Can you maybe tease out a little more what the growth investment impacts are for this year? I don't know if you'd size them for us and how we think about the growth in SG&A beyond this year. Is there an opportunity to maybe harvest some of that leverage as you get sales associated with these investments or is it best to think about SG&A may be holding the line and growing with sales longer-term? That's my first question.

Michael McMullen
Senior Vice President, Chief Financial Officer & Treasurer, YETI Holdings, Inc.

A

Yeah. Hey, Peter. Thanks for the question. Here's what I'd say. In Q2, we said the primary drivers were; number one, incentive compensation; and number two, investing and then compounded by the fact that the stop sale obviously increased the impact on our leverage. From a dollar growth perspective, obviously the incentive compensation had a pretty big impact in Q2. As we think about the year, we've said it's really four things. Number one, the increase in variable expenses and a big piece of that is going to be related to the growth of our Amazon business; two, incentive comp; and then three, the investments we're making. In terms of where and how much, we haven't given too much granular detail on that. But what I'd say is it's really around head count, demand creation, technology, et cetera to drive future growth. And that's both in outside the US in terms of building out our teams, growing brand awareness and inside the US in terms of building out our teams here to help drive the product roadmap.

In terms of where it goes from here, we certainly do not expect to have the disconnect between the growth in sales and the growth in SG&A going forward. It is our intention to try to have SG&A grow more in line with sales. And we just look at this year as somewhat of an atypical year given some of the factors that I mentioned. And so; I do think you'll continue to see increases in variable as we obviously expect DTC to see to grow faster than sales. We'll continue to invest in the business, but this year with the stop sale, it's just the investments that we're making or having a bit of an outsized impact. And it was just our intention to continue to invest despite the impact of the recall.

Peter Sloan Benedict
Analyst, Robert W. Baird & Co., Inc.

Q

Okay. That's super helpful. I guess just the follow-up would be maybe to Matt or Mike. Plenty of cash on the balance sheet here. You're increasing your free cash flow view to $150 million to $200 million this year. Maybe

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latest comments or thoughts you would have on how to kind of leverage your considerable financial strength as we look out to the back half of this year and then longer-term. Thank you.

Matthew J. Reintjes
President, Chief Executive Officer & Director, YETI Holdings, Inc.
A

Excuse me. Good morning, Peter. I'll take that one. We've been consistent in – we believe this business can continue to drive strong margins and can continue to be a strong free cash flow generator. As we look forward with our cash position and the cash generation potential, we first and foremost prioritize investment in the business that we believe sustains the growth potential and the expansion that we're driving, both domestically and globally.

Secondarily, we'll continue to look at uses of cash that we believe feed and kind of fund the innovation engine. As I mentioned earlier, the brand reach that we have and the brand reach that we continue to build creates opportunity for innovation underneath that halo; and we think there are strategic uses of cash where we can bring innovation into the YETI portfolio and then leverage the incredible marketing and commercial teams that we have to go drive outsized returns. And so that would be our primary and our top two focuses would be continuing to be best in the business and find strategic innovation opportunities or targeted M&A opportunities to leverage the YETI brand and leverage the YETI platform.

Peter Sloan Benedict
Analyst, Robert W. Baird & Co., Inc.
Q

Great. Thanks so much, guys. Good luck.

Operator: Thank you. Next in line, Ms. Sharon Zackfia with William Blair. Please go ahead.

Sharon Zackfia
Analyst, William Blair & Co. LLC
Q

Hi. Good morning. I was hoping to delve a little bit more into the Drinkware segment. I mean obviously growth of 8% is good. I'm wondering, though, is that kind of a good barometer of underlying demand right now or do you think you need to see any kind of, I guess, impact from retailers still not wanting to have as much inventory on the shelves? Just any thought process on underlying demand on that segment will be helpful. And then as it relates to international growth in the back half, what are your expectations there?

Matthew J. Reintjes
President, Chief Executive Officer & Director, YETI Holdings, Inc.
A

Thanks, Sharon. I'll take the Drinkware and Mike can step in on the international. You know, our Drinkware is and has been, as I mentioned like in the prepared remarks for going on a decade been a really important part of our business. We continue to see that resonate both our product portfolio, our sizes and our colorways resonate with consumers. We mentioned the recent colorway launch. So when we look across the horizon, we feel really good about where our Drinkware business not only is positioned today, but where it's growing. We have incredible partners in our wholesale partners that have been longstanding and they've seen the success not only of YETI every day, but when we bring innovation and when we bring newness to the market; and that hasn't changed. We're having great conversations with our wholesale partners. We're seeing great acquisition and retention across our DTC channels, in our corporate and B2B business; continued resonance within Drinkware.

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So, I think we built a sizable business in Drinkware. What I'm most pleased with is the continued receptivity we're seeing to innovation in the domestic market, but also the reception we're seeing globally. And I think that, tying into your second question, remains a significant and out there for us opportunity.

Michael McMullen
Senior Vice President, Chief Financial Officer & Treasurer, YETI Holdings, Inc.
A

And Sharon, on the international question. So, grew 19% in Q2. That was a bit of step down from Q1, both from a growth as well as a mix perspective, but I think what I'd highlight is ANZ and Europe continue to grow really nicely. Canada's been impacted by some of the dynamics that we've talked about in the US regarding the recall, but we expect that to return to growth as we go into the second half. You know, here's what I'd say. We think that we can continue to increase our international mix over time, and as we go into the second half. So, I do think that we will see the international business grow faster than the US. How much? We don't typically give specific guidance on that other than to say we feel really good about our business outside the US and it has a pretty significant opportunity in front of it.

Operator: Sharon, does that answer the question?

Sharon Zackfia
Analyst, William Blair & Co. LLC
Q

Yes. Thank you.

Operator: Thank you. Next in queue is Joe Altobello with Raymond James. Please go ahead.

Joseph Altobello
Analyst, Raymond James & Associates, Inc.
Q

Thanks. Hey, guys. Good morning. Kind of a big [indiscernible] (00:45:06) question if I could. But if we put all the noise from this year side, the recalls, the retail order patterns, et cetera; it does sound like you think YETI is still a double digit sales grower. And so given that maybe could you give us a little bit more color on how those sales drivers may have changed over the past couple of years?

Matthew J. Reintjes
President, Chief Executive Officer & Director, YETI Holdings, Inc.
A

Thanks, Joe. I'll take that one. I would say, the growth drivers haven't fundamentally changed in our belief on what's possible, but the importance of them has changed. The domestic market, obviously, is our largest market. What we continue to see is receptivity across the product portfolio. We called out on the call the strength of Coolers & Equipment, and we specifically called out the strength of hard coolers. That's our longest standing product, really our origin story, continue to resonate when we see the success we're having across the domestic regions and the strength from all those. I think that story remains intact.

Those are also the markets that are hungriest for innovation and that are hungriest for expansion. And that's the focus of our incredibly talented product development and supply chain operations teams is continue to drive innovation to our longest standing customers. And then, globally, we've talked a lot about the international opportunity for YETI. And a few years ago, it was a concept; and today, it's a really meaningful part of the business but still very early in that evolution in some of the largest, and we think, most attractive markets internationally, particularly in the UK and Germany, within the greater UK, Europe. And those all remain, we believe, intact and in front of us. So, the execution remains the same. We continue to drive the brand heat and

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growth of the brand, continue to drive innovation underneath that, and then execute and build the structure that can support YETI well into future growth.

Joseph Altobello
Analyst, Raymond James & Associates, Inc.

Q

Got it. Very helpful. And maybe just to kind of transition over to the margin. You touched on this earlier, but what do you see as the key margin drivers for 2024? Obviously, in [ph] down freight (00:47:19) continued benefits there, but could you guys build on the 60% DTC penetration, for example? And what are the drivers are there?

Matthew J. Reintjes
President, Chief Executive Officer & Director, YETI Holdings, Inc.

A

Yeah. Joe, I think, you hit on what I think will be the biggest one in 2024 is to continue to benefit from those inbound container rates. We did say also this quarter we expect now to see a benefit on the product cost side. Where that goes and where some of the other factors we called out in terms of FX and I think we'll have to see where that plays out. But what we've said consistently is that we believe there's an opportunity to grow DTC faster than wholesale, which could provide some benefits. On the category side, traditionally drinkers had a higher gross margin than coolers and equipment. I think that could be something depending on where those categories grow in relation to each other, we expect to be able to grow both of them. So we'll have to see, but what the impact from sales mix is, but I think the biggest thing to call out is the benefit will be continued benefit from inbound container rates.

Joseph Altobello
Analyst, Raymond James & Associates, Inc.

Q

Got it. Great. Thank you, guys.

Operator: Thank you. Next in line is Robby Ohmes with Bank of America ML. Please go ahead.

Robert F. Ohmes
Analyst, BofA Securities, Inc.

Q

Oh, thanks. You know, my first question is for you, Matt. Can you give a little more color? I think you mentioned consumer conservatism, some smaller basket sizes, some change in [ph] UPTs (00:49:00). You know, is that – are you seeing customers trading down or what is conservatism and do you think it'll last through the back half?

Matthew J. Reintjes
President, Chief Executive Officer & Director, YETI Holdings, Inc.

A

Good morning, Robby, and thanks for that. I would say there's a few things going on and we talk about. We use terms like it's a dynamic environment and we're not seeing consistencies among channels, and that remains true. The sum total is we feel really good about where the brand is, we feel good about where the business is, we feel good about the opportunity in front of us. The way it's coming in, I would say, has been more inconsistent than we've seen [indiscernible] (00:49:39) and that causes our team, in particular, our advanced analytics team to dig in deeper and look for themes. Where we're seeing a bit of the conservatism, I would call in those in-between buying moments. We're seeing customer counts continue to rise. And that's not just in our retail and in our e-commerce business, but also in our corporate sales business where we're seeing some smaller kind of units per transaction, which we don't have a direct attribution to why we're assuming, that's a little bit of buying conservatism.

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So, they're still coming back. They're still buying. I wouldn't call it a trade-down scenario because there's not a trade-down play within our portfolio and I don't know if there's a trade-down play against YETI. We said all along that YETI has been a want demand or want brand since its beginning. We've never lived in a need category. I think what's most promising is that in those natural buying moments, the moms, dads and grads, we're continuing to see the consumer show up. And so, our team's focus is in what I'll call those in-between buying moments, which leads to some of our strategy on how we release a product, how we kind of launch our marketing campaigns.

You just saw the Cosmic Lilac and Camp Green. The reason we put that in July is there's not a natural buying moment. It's in between some buying moments. And so we thought, what a great time to bring out a winning color and put it in the market. So those are the things that are adjusting our philosophy a little bit, but we think overall, we're seeing the success and the receptivity to innovation. We're seeing success and receptivity to brand; and we're seeing a little bit of different consumer dynamic across our channels.

Robert F. Ohmes
Analyst, BofA Securities, Inc.

Q

Got it. That's helpful. And then just a quick one for Michael. For the guidance, I think you said it doesn't include – in the back half doesn't include any further gift card redemptions. Obviously, there's going to be some – how are you going to report going forward? Are there going to be other – are there going to be similar adjustments to revenues in 3Q and 4Q? Could there be any more recall reserve increases from here; maybe a little help on that?

Michael McMullen
Senior Vice President, Chief Financial Officer & Treasurer, YETI Holdings, Inc.

A

Yeah. Hey, Robby. So, thanks for the question. Here is what I'd say. And I think we need to separate the adjustments that we made to our GAAP results from the gift card redemptions. So, the adjustments that we made in this quarter are essentially us updating our assumptions for the entry that we made in Q4 of last year. So, we've seen some different consumer behavior than we expected slightly. So, we've seen people choosing more gift cards as opposed to value in-kind product remedies. And so, we're updating our sales and cost of sales assumptions related to that. We've also seen logistics costs related to the recall come in lower than we expected. So, we're making that adjustment as well. I don't know, we'll see how things play out. But assuming behavior stays the way it has played out thus far in the recall, we're trying to reflect in this reserve adjustment like what we expect to see for going forward into the future in terms of consumer behavior.

Now, when we talk about the gift card redemptions, what we're talking about is consumers coming back and using that gift card with us for a sale. And so, we wanted to call that out because we think it's important for you all to know. It's not an adjustable item given for a number of factors, but we will continue – assuming that it is material, we'll continue to call that out in the second half. To your point, we're going to continue to have gift card redemptions whether it's higher or lower. When it happens, we don't really know yet, which is one of the reasons why we didn't call it out or didn't include it in our second half outlook.

Robert F. Ohmes
Analyst, BofA Securities, Inc.

Q

But just so I understand if I understand the math; there's $12.5 million of gift cards outstanding at the end of the quarter, right; so going into 3Q. So, if those are all redeemed, that would be upside to the revenue guidance?

Michael McMullen
Senior Vice President, Chief Financial Officer & Treasurer, YETI Holdings, Inc.

A

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Just the $12.5 million were redemptions that we saw in Q2. As we disclosed in our Q, there are roughly $10 million of redemptions that have yet to be – there are gift cards that are out there that have yet to be redeemed and could be redeemed at some point in the future.

Robert F. Ohmes
Analyst, BofA Securities, Inc.

Q

Got it.

Michael McMullen
Senior Vice President, Chief Financial Officer & Treasurer, YETI Holdings, Inc.

A

So, those are two different numbers.

Robert F. Ohmes
Analyst, BofA Securities, Inc.

Q

Got it. So, $10 million of potential upside to the back half revenues on the redemptions versus guidance.

Michael McMullen
Senior Vice President, Chief Financial Officer & Treasurer, YETI Holdings, Inc.

A

Well, I mean, it really kind of comes down as to when those are redeemed.

Robert F. Ohmes
Analyst, BofA Securities, Inc.

Q

Got you. All right. Perfect. Thank you, Michael.

Michael McMullen
Senior Vice President, Chief Financial Officer & Treasurer, YETI Holdings, Inc.

A

Welcome.

Operator: Thank you. Next in line is Peter Grom with UBS. Please go ahead.

Peter Grom
Analyst, UBS Securities LLC

Q

Thanks, operator; and good morning, everyone. So, maybe just following up on Matt just quickly, can you maybe give us a sense what you've seen on the gift card front quarter-to-date or kind of halfway through 3Q. So, have you seen that kind of redemption continue through the first six or seven weeks here into 3Q?

Michael McMullen
Senior Vice President, Chief Financial Officer & Treasurer, YETI Holdings, Inc.

A

We've certainly seen some additional redemptions. We'll have to see where the number lands for the quarter. There's a lot of factors there, but we have certainly seen some additional redemptions come through.

Peter Grom
Analyst, UBS Securities LLC

Q

Got it. That's really helpful. And then I guess just following up on the gross margin components. I know the expectation was for freight actually less of a benefit this quarter versus Q1 as you're largely cycling it through last

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quarter, and that obviously didn't happen. So just as we think about the bridge, would you expect freight and product cost improvement to continue to build sequentially from here? And I guess I'm just trying to understand how we should be thinking about the broader phasing of gross margin in 3Q versus 4Q? Thanks.

Michael McMullen
Senior Vice President, Chief Financial Officer & Treasurer, YETI Holdings, Inc.
A

Yeah. So, what I would say is we – this quarter, the two biggest drivers and we specifically called them out were inbound freight and product cost. The second thing is we've consistently said that, margins are going to increase – the year-over-year increase in gross margins is going to go up sequentially as we go through the year; and that's certainly still our intention as well or what we see for the second half as well. In terms of specific drivers and how those will play out, we haven't really gotten down to that level of detail other than to say the biggest driver this year will be inbound freight. And now we're comfortable saying that product costs are going to be benefit for the year. There's going to be some quarters where that goes up, down but for the year we're very comfortable saying that it will be slightly favorable, which is part of the reason why we're comfortable taking our margins up for the year.

Peter Grom
Analyst, UBS Securities LLC
Q

Got it. Thanks so much. I'm passing on.

Operator: Thank you. Next in queue is John Kernan with TD Cowen. Please go ahead.

John Kernan
Analyst, TD Cowen
Q

Excellent. Thanks for taking my question. So just curious on DTC and how we go into next year and think about the long-term contribution margin from DTC. It's now 50% of revenue. Obviously, some of the product recalls have affected mix this year, but just curious on how we should think about DTC, the overall contribution margin and benefit to both the gross margin, the operating margin line going forward? Thank you.

Michael McMullen
Senior Vice President, Chief Financial Officer & Treasurer, YETI Holdings, Inc.
A

Yeah. So, John, thanks for the question. Here's what I'd say. So just to be clear, it was – 55% of our mix in Q2 roughly the same as in Q1. And we expect the year to end at approximately 60%. You know, I'd come back to without getting into too much detail as to what we expect in 2024, we'll obviously have a lot more to say about that on future calls. But it is our intention to try to grow DTC faster than wholesale. We've been clear in the past that, DTC has a higher gross margin than wholesale. But once you get down to the operating lines, like they're much closer. And it really kind of – the other thing to keep in mind is that DTC is a relatively broad umbrella. There's a number of different sub channels under that, that have different overall profitability, e-commerce versus stores versus corporate sales versus Amazon. So, we do think obviously that as DTC grows faster than wholesale, there's going to be a benefit on the gross margin line, but we need to kind of make sure we balance that with some additional costs that that channel drags as well.

John Kernan
Analyst, TD Cowen
Q

Got it. maybe just one follow-up question. Don't mean to beat the gift card redemptions in here too much, but is there anything from a flow-through perspective on the margin line that we should be aware of just as you

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potentially recognize more of the gift card redemptions going in the back half of the year? Does that flow through [indiscernible] (00:59:31)?

Matthew J. Reintjes
President, Chief Executive Officer & Director, YETI Holdings, Inc.

A

I'm sorry, John. Go ahead.

John Kernan
Analyst, TD Cowen

Q

I was going to say does that flow through at a normal margin level? Is there anything we should be thinking about in terms of the actual incremental margin from those retention?

Matthew J. Reintjes
President, Chief Executive Officer & Director, YETI Holdings, Inc.

A

Yeah. I mean, I think the only thing that I would call out is that it's somewhat connected to your first question is, that they're obviously all a DTC sale and specifically an e-commerce sale. So, I would say that they flow through at a gross margin rate that is slightly higher than our overall average just by the fact that they're an e-commerce sale.

John Kernan
Analyst, TD Cowen

Q

Got it. All right, guys. Thank you.

Operator: Thank you. Next, we have the last question from Xian with BNP Paribas. Please go ahead.

Xian Siew
Analyst, BNP Paribas Exane

Q

Hi, guys. Thanks for the question. I think last quarter you mentioned wholesale is expected to be down low-double-digit in 2Q and 3Q, and sounds like there is just the shift there in the wholesale outlook, those two quarters are still the same. I guess is 3Q expected to be down high-teens? I know you mentioned down double digits, but maybe a finer point on that.

Michael McMullen
Senior Vice President, Chief Financial Officer & Treasurer, YETI Holdings, Inc.

A

Yeah. Hey, Xian. So, thanks for the question. I think you're right. I mean, we did initially say both would be down low-double-digits. Wholesale obviously performed better. There's a number of different factors driving that. One of which is the earlier launch of fall season or in Q3, our Camp Green and Cosmic Lilac colors. That necessitated us starting to shift those into the wholesale channel in Q2 which was not in our prior outlook. So, I view those as purely just a shift from Q3 into Q2. As you look across the first three quarters of the year, there's really nothing change.

So, I do think what you're asking essentially is wholesale going to be worse – or lower growth in Q3 than our prior outlook, I think, the answer is yes. And as we said in the script, it will be in the kind of mid- to high-double-digit range of decline in Q3, but again as you think about the first three quarters of the year or even the full year, nothing is really changed. With one more call out, part of that growth in Q3 is going back to a very strong comp for wholesale in Q3 of last year as – that's really when the wholesale channel caught up on inventory.

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Xian Siew
Analyst, BNP Paribas Exane

Q

Got it. Very helpful. Maybe just a quick one, maybe can you just remind us, Canada, how big it is now as a percent of international relative to like Europe?

Michael McMullen
Senior Vice President, Chief Financial Officer & Treasurer, YETI Holdings, Inc.

A

Yeah. We haven't given that level of detail other than to say it's our biggest international region, but we haven't given the specifics of that country specifically. And just going back to some of the earlier comments, Canada did grow in Q2. It's just part of our overall international region, but we expect it did see some of the same impacts in the US in terms of the recall impact and we expect that growth to accelerate as we go into the second half.

Xian Siew
Analyst, BNP Paribas Exane

Q

Got it. Thanks. Thanks, guys.

Operator: Thank you. This concludes our question-and-answer session. I would like to turn the conference back over to Matt for any closing remarks.

Matthew J. Reintjes
President, Chief Executive Officer & Director, YETI Holdings, Inc.

Thank you, operator, and thanks to all for joining us. We look forward to speaking later this fall and updating you on the continued growth and progress of YETI.

Operator: Thank you. The conference has now concluded. Thank you for attending to this presentation. You may now disconnect your lines.

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