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PRESENTATION

Operator

Hello, and welcome to the First Quarter 2022 Swedish Match Earnings Conference Call. (Operator Instructions) And today, I'm pleased to present Emmett Harrison, Senior Vice President of Investor Relations. Please begin your meeting.

Emmett Harrison - *Swedish Match AB (publ) - SVP of IR & Corporate Sustainability*

Thank you. This is the Swedish Match First Quarter 2022 Telephone Conference. And with me today are Lars Dahlgren, our President and CEO; and Anders Larsson, our CFO. In the Investors section of our swedishmatch.com website, you will find our Q1 investor presentation.

This morning, we announced that the Board of Directors of Swedish Match recommend to shareholders to accept an all-cash offer by PMI for all of the outstanding shares of Swedish Match. A separate press release on this matter was published earlier today and provides further details on the Board's evaluation of the offer. And the script today will exclusively focus on the developments during the first quarter. We encourage you to have that Q1 2022 investor presentation at hand as you listen to our prepared commentary during this call.

Several of the slides in the investor presentation repeat key messages from the interim report that we published this morning. We will, therefore, focus our commentary on a smaller number of slides that we have selected. And while doing so, we will refer to the applicable page number of the presentation. Unless otherwise stated, all comparisons are versus the prior year's corresponding period. For U.S. smoke-free and cigars, comments on financial developments are made based on results achieved in local currency measured in U.S. dollars. After our prepared commentary, we will be taking questions.

During today's call, there may be certain comments that constitute forward-looking statements and are subject to risks and uncertainties. Management believes that these statements are based on reasonable assumptions but can give no assurance that expectations will be achieved. Risk factors are outlined in today's interim report as well as the annual report, which are available on our website. Swedish Match assumes no obligation to update information concerning its expectations. A recording of this call will be made available on the Swedish Match website. And with that, I'd like to hand the call over to Lars.

Lars Dahlgren - *Swedish Match AB (publ) - President & CEO*

Thank you, Emmett, and good afternoon, everyone. I'm pleased to report that we have begun 2022 on a strong note when taking into consideration the unusual and exceptionally strong first quarter last year in some parts of the group. In last year's first quarter conference call, I highlighted that

there were timing effects that positively impacted shipments in Scandinavia, including inventory replenishment in Norway and extra Easter deliveries, while we also have noted that we benefited from positive channel mix impacting average price due to COVID-related travel restrictions.

I'm particularly encouraged by the development of ZYN nicotine pouches in the U.S. where not only we have continued strong volume development, but also have consistently retained our strong market share over the past several quarters, and have sequentially added to our already best in category store velocities. In Scandinavia, we made sequential share gains for nicotine pouches in Sweden. And with the heavy schedule on new product introductions now from May, we are hopeful that we can gain further traction.

For our cigar business, last year's first quarter results included record shipments, sales and operating profit as we realized the benefits of our dual production setup during the peak of COVID-19, a benefit that several competitors did not have. Our first quarter 2022 performance didn't match the record results from the prior year, but we did see sequential improvements versus Q4 as our decisions to prioritize our Game natural leaf cigarillos, given our supply chain constraints, proved beneficial. As we continue to incur constraints within the cigar business, production levels in our other businesses have been largely unaffected from strained global supply chains and cost increases have been mitigated by price increases for most products in our portfolio.

The tragedy of the war in Ukraine has somewhat limited business impact for Swedish Match. Historically, Russia has been one of the larger markets for our pocket lighters, but that business has now been suspended. In 2021, sales to Russia represented around 8% of sales within the Lights product segment and less than 1% of total sales for the group. In light of FDA's recent announcement regarding its path forward to ban on menthol cigarettes and flavored cigars, we have repeatedly stated that we believe that comprehensive product standards regarding flavors applicable to the entire cigar category are preferable to the FDA potentially attempting to restrict or limit flavored cigars on the market through what could have been more arbitrary process, for example, through the SE route. The FDA's proposed rule in flavored cigars will undoubtedly be a long and dynamic process, and we continue to believe that we are well positioned in a flavor-ban environment given the breadth of our cigar portfolio.

The reported group top line growth of 2% in local currencies for the first quarter is less than the growth rates that we have been delivering in recent quarters. However, to a large extent, this was caused by the special factors in Q1 of the prior year. Swedish Match continues to be very well positioned for growth, and our quality of revenues continue to improve.

Nicotine pouch markets across our geographic reach continue to exhibit significant growth. Slide 7 of our investor presentation reflects the increasing contribution to group sales from nicotine pouches. In Q1, nicotine pouches comprised 29% of group sales from product segments and more than 40% of sales for the smoke-free segment, with both reference points up substantially from 2 years ago.

Following these introductory remarks, we will now continue with some more detailed comments on the smoke-free product segment and starting with ZYN on the U.S. and turning to Slide 9. The slide illustrates the impressive volume trajectory we've seen in the U.S. on a 12-month rolling basis, with shipments up by 35% to close to 50 million cans in the quarter, the rolling 12-month shipment volumes amount to 187 million cans of ZYN. Similar to previous quarters, for ZYN, the majority of the volume growth was attributable to increased velocities in existing retail outlets. At the end of Q1, distribution for ZYN had reached 129,000 stores, up by 14% from Q1 in the prior year. And what's even more encouraging is the fact that the solid trends of growing velocities for ZYN have continued in the original launch markets in the West as well as the national expansion markets. Furthermore, the overall category dynamic where nicotine pouch velocities in expansion markets closely track with earlier trends we saw in the West based on comparable months in the market remain true in Q1.

Looking at Slide 10. Nicotine pouches continue to demonstrate not only exciting commercial prospects, but also their potential to significantly contribute to improved public health. Measured by volume relative to cigarettes, when equalizing 1 can on nicotine pouches with 1 pack of cigarettes, we now estimate that the nicotine pouch category is trending towards a 10% benchmark in the West, and it's close to 3% on a national level already. In terms of number of consumers, the nicotine pouch users have likely already surpassed the 10% benchmark in the West. And on a national level, we estimate the number of nicotine pouch consumers to be around 5% relative to the number of smokers. Consumers of traditional smoke-free products are also a source of growth for the nicotine pouch category.

Looking at Slide 11 and benchmarks based on MSA data that measures shipments from distributors to the trade, one can see that in the West, shipments of nicotine pouches exceeded 2/3 of the shipments of traditional moist snuff in the quarter. And as a testimony to the brand equity of

ZYN, a milestone was passed in the West during the first quarter with ZYN growing to become larger than the Copenhagen Moist Snuff brand, the leading moist snuff brand that has been in existence for 200 years.

Turning to quarterly market share for ZYN and category volumes based on shipments from distributors to the trade on Slide 12. You will note that the market shares for historic periods for ZYN have been revised slightly upwards based on updates of the MSA data set, but that the historical trends are the same as previously published data. For the most recent quarter, ZYN's continued sequential share gains are particularly impressive, given the rather extreme competitive promotional activity, especially from 1 competitor. Towards the end of the first quarter, a large competitor supplied a specific chain with extraordinarily high volumes and run a program in that chain where consumers were offered a free can of their nicotine pouch product with the purchase of any other tobacco product. Adjusting for these extra shipments for this isolated promotion, ZYN's sequential market share gain would have been notably higher and the performance for ZYN is a testament not only to the strong brand equity and (inaudible) with consumers, but also the outstanding capabilities of our organization.

The market share for ZYN in the West during Q1 was 79% in volume terms and in the expansion markets, the number was 59%. Since more pronounced first mover advantage in the West is a clear asset, but it's worth noting that in the expansion markets since Q1 market share was higher than in Q1 of last year as well as sequentially higher compared to the fourth quarter, indicating that ZYN's success is much more than simply being first in the market.

With that, I will give the word to Anders.

Anders Larsson - Swedish Match AB (publ) - CFO & Senior VP of Group Finance

Thank you, Lars. Turning to Slide 13 and traditional moist stuff, while the moist snuff category is showing increasing softness down 4% on a 12-month rolling basis according to MSA in volume terms, Swedish Match is very well positioned with its value-priced Longhorn brand in the current inflationary environment. And there, many consumers are seeing their purchasing power eroding. Q1 moist snuff shipments were up on the back of the positive market share trajectory for Longhorn and similar to the rest of the category, Swedish Match also enjoyed improved pricing.

Turning to Smokefree Scandinavia on Slide 15. At the beginning of the quarter, travel restrictions due to the Omicron variant were still largely in place. But later in the quarter, there was a significant ramp-up in activity at border and travel retail classes of trade. With these channel shifts, the timing of Easter this year relative to the prior year and significant replenishment of trade inventories in domestic channels in Norway in Q1 of the prior year, it is challenging to get the precise read on underlying market growth in Q1. However, looking at Nielsen data and shipments to consumers from online platforms, it is clear that a very healthy category growth persisted. For full year 2021, we estimated category growth to have exceeded 10% in volume terms and Swedish Match assessment is that the market continued to grow at least at this level in Q1, with the growth being comprised of stable to slightly growing snus markets, coupled with continued strong double-digit growth for nicotine pouches.

Slide 16 zooms in on the snus market and Nielsen data. Snus represents the vast majority of the Scandinavian smoker category. And Swedish Matches market share was down marginally from Q4 levels with a slight share erosion in Sweden being partially offset by share gains in Norway. Within nicotine pouches, as depicted on Slide 17, Swedish Match gained a little bit of market share sequentially from the fourth quarter, driven by share gains in Sweden. We are very pleased to note that the VOLT series continued to trend well, while the portfolio ZYN products with regular sized pouches has started to grow market share again, indicating that the cannibalization issues that we are experiencing are subsiding.

The most exciting news for nicotine pouches in Scandinavia, however, occurs as we speak now during the second quarter and Slides 18 and 19 provide some snapshots. This week, we are starting to execute expansions and improvements of the Swedish nicotine pouch portfolio at historically ambitious levels. The current VOLT assortment is being upgraded with pouch size, mouthfeel and characteristics, carefully developed with a consumer-centric approach. Moist mini pouches are being introduced under the VOLT brand name, and the Swave range is being extended by 1 additional SKU in the mini format. As for the Mini dry portfolio ZYN, it will be enhanced with a broader range of flavor offerings.

We are particularly thrilled about the introduction of the PEARLS technology, where the VOLT brand will be the first to benefit from extensions based on this exciting innovation. With its patent pending technology, PEARLS offers a clearly differentiated sensory and sensational properties,

not least of which is the ability to manage release properties for both flavors and nicotine delivery which has resulted in a first set of products that have been received exceptionally well in prelaunch consumer testing.

Furthermore, we have just started the launch of our new brand RUSH in Norway. RUSH is launched with 5 new product brands with the same upgrades as VOLT on pouch size, feel and characteristics. RUSH is tailored for Norwegian consumers using the base from both, including key results and communication elements.

Turning to Slide 21 and cigars. While volumes, sales and operating profits saw a marked improvement from Q4 levels, we are still working through issues relating to shortages of certain input materials, generally, steep cost increases for raw materials and transportation as well as some labor productivity issues. When comparing to the prior year financial performance, one should remember that Q1 of the prior year was a record quarter, and where Swedish Match could benefit from its dual factory footprint as competition faced constraints on production. As measured by shipments from distributors to the trade, the category showed some softness in the first quarter with year-on-year volume declines of close to 10%. However, on an underlying basis, and as supported by consumer offtake data, we estimate that cigar demand has held up somewhat better and remains well above pre-COVID levels with the difference attributable to inventory moments at retail as the industry is making progress with strained supply chain.

For Swedish Match, specifically, we are very pleased with the progress we have achieved with production output for our Game natural leaf cigarillos, which constitute the majority of the natural leaf portfolio. We have now come to a point where we can build more adequate inventory of these varieties, and we expect a notable pickup in sales over the course of the year. The increased sales of Game natural leaf cigarillos was the driving factor behind our slight year-on-year market share gains, while for natural rolled leaf, we continue to address some challenges. The shortage on certain input material impacting our production output is more pronounced for HTL cigars. And this is also the segment where we benefited relative to competition in the prior-year period.

On the issue of nonsubstantial equivalence designations, the status is unchanged with MSAs received for SKUs corresponding to 3% of the 2021 cigar volume. We have now following our requests received more detailed information from the FDA, providing additional support for the request for a supervisory review, which we have now filed for and we remain confident that Swedish Match will be given the opportunity to provide the FDA with sufficient data in order to demonstrate that the cigars in question are substantially equivalent to their predicate products insofar that the changes that have taken place to not raise questions of public health.

Slide 24 restates our 2022 outlook from the interim report, which remains unchanged from the Q4 report with the exception that we do not expect any significant further costs relating to the contemplated U.S. listing of the cigar business during this year. We continue to believe that nicotine pouches represent exceptionally attractive growth opportunities across markets as more and more consumers navigate the reduced risk products landscape. And Swedish Match remains very well positioned to pursue these opportunities with resolved passion and determination.

Finally, as always, fluctuations in currency rates will impact our future reported results, and you may want to take note of some of the more important average exchange rates versus the SEK. The average exchange rate in the second quarter of 2021 for the U.S. dollar was 8.41, the NOK1.0 and the Brazilian real 1.59. In other words, should current spot rates largely prevail, one should expect significant currency tailwind in the upcoming first quarter for sales and earnings.

And with that, operator, please open the line for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Owen Bennett from Jefferies.

Owen Michael Bennett - Jefferies LLC, Research Division - Equity Analyst

A couple of questions, please. Firstly, could you maybe just talk about the latest trends you're seeing with regard to where ZYN or modern oral is sourcing volumes. You've previously given data across cigarettes, vape and traditional snuff. I was just wondering, has that changed at all? Or have you got any latest data on that?

Lars Dahlgren - Swedish Match AB (publ) - President & CEO

We don't have any updates there to share. The picture is the same in the sense that the answer is all of above. And if we compare to the more recent history compared to further time back, we see an increasing share coming from cigarettes and vape.

Owen Michael Bennett - Jefferies LLC, Research Division - Equity Analyst

Okay. And then just my second question, you previously outlined this year significant investment in global rollout of modern oral into market in Europe, for example. Can you maybe talk about any early trends you're seeing there and whether it's going better or worse than you would hope for?

Lars Dahlgren - Swedish Match AB (publ) - President & CEO

We continue to see opportunities in other markets. That's an integral part of our strategy to expand our offering in those geographies as well. And then more specifically, in terms of as we enter potentially new markets, we will discuss those when we have become present in those markets.

Operator

And the next question comes from the line of Gaurav Jain from Barclays.

Gaurav Jain - Barclays Bank PLC, Research Division - Research Analyst

Congratulations on the deal. There have been a lot of strategic actions in the last few months in Swedish Match. You had the cigar spin-off in September and then it was called off and then there were rumors in the press around this Philip Morris deal which has finally happened. So can you just help us understand what has happened in the company in the last 6 months from all the strategic perspectives?

Lars Dahlgren - Swedish Match AB (publ) - President & CEO

First of all, let's just be clear, what do you say, the PMI deal. I mean, it has not happened. An offer has been presented, and it's up to the shareholders. I interpret your question as what has happened in terms of momentum in the daily business and organizational morale. I don't know if that is the correct interpretation. Otherwise, I'll get back to it. But I would say that, of course, you take the cigar, the plan to separate the cigars, which remains the strategic intent of the Board. As you can note, not the least from the costs that we have incurred both in Q4 and also in this quarter, it's been a very intense project with a lot of preparations.

So a lot of people have worked very hard on that project. But that has predominantly been what I would call head-office type of functions and including the U.S. division head-office then. So business-wise, we have continued to execute on the plans. And when it comes to the recent announcement, it's obviously very new, but -- so it's going to be an important aspect. But I say it's reassuring not only the strategic rationale of the potential transaction, but also the communication that has been presented by PMI in terms of their view on how the Swedish Match organization and capabilities could be leveraged for further accelerated growth with modern oral and other oral nicotine products.

Gaurav Jain - *Barclays Bank PLC, Research Division - Research Analyst*

Sure. And clearly, a lot of questions as to how this 106 SEK offer. Clearly, the Board has recommended it to shareholders. So the Board thinks it is the right fair value. Now if I look at your numbers, so ZYN's pricing Y-o-Y is down 8%, 9% in a market which is a duopoly, and one can argue it's the low point of the cycle on pricing. And Altria always say that their aim is to maximize profitability. And despite this negative pricing, ZYN margins were actually quite strong. I think they were down to 300 basis points. So aren't you at the risk of selling at the low point of pricing competition versus Altria, We all know CPI inflation of 7% in the U.S.

Pricing, ZYN also will strengthen if I look out over the next 2 years.

Lars Dahlgren - *Swedish Match AB (publ) - President & CEO*

The line is a little bit choppy, but I think I got most of your question. I mean when it comes to whether the shareholders will sell or not in the offer that is naturally up to the shareholders. The Board has issued its recommendation. When it comes to the pricing on ZYN, we have been clear that we are investing more behind ZYN in the U.S. and some of which is possible to do now that they couldn't do before, if you look, for example, 1 year ago in terms of consumer engagement activities and so forth due to COVID restrictions. And it comes to the net pricing that you see, there is an increase in investment in terms of the loyalty programs with the trade, which we've been speaking about for a long time.

And then when it comes to finally some of the promotional element, there has been a little bit of promotions for ZYN as well in the first quarter or stepped up to some of the periods before. But at the same time, we've been very clear that for ZYN, that doesn't mean that the whole year will look the same. There is timing in terms of promotional schedule and the promotions that have been offered on ZYN to consumers are nowhere near that we see that we have witnessed from our main competitor.

Operator

(Operator Instructions) Our next question comes from the line of Faham Baig from Credit Suisse.

Mirza Faham Ali Baig - *Crédit Suisse AG, Research Division - Research Analyst*

I've got 2 as well, please. The first one on U.S. nicotine pouches and ZYN. I think it's probably the lowest sequential increase that we've seen in volumes for at least the last 2 to 3 years, particularly considering Q4 has historically been a lower consumption quarter. I was a bit surprised with that. I guess the question there is was this significantly impacted by the competitive sort of loading that you pointed out to 1 particular consumer? Or was there something else? Because you mentioned the promotional activity and the benefits you've seen with that? And to be honest, the retail data that we've been monitoring was pointing to a better quarter than what was printed. So was there any sort of sell-in versus sell-out dynamic that you can point to? And I've also got one other question.

Lars Dahlgren - *Swedish Match AB (publ) - President & CEO*

Well, first of all, the usual caveat that please look at the long-term trends and nothing fundamentally has changed in terms of the velocities continue to grow for ZYN, and regarding -- given that we started the year with a promotional program for the trade, yes, I think we discussed this in connection with Q4, there was a bit of buy-in of volumes from the trade. And what we are reporting here is, for example, on the slide number there, I don't have it in front of me now, but where we have the market shares by quarter, that is based on MSA data. So it's shipments from distributors to the trade. And when you look at retail data, that is obviously more reflecting consumer offtakes.

So in that sense, it's certainly reassuring that what you're seeing in the retail data. And if you look at -- we're getting better retail data and including IRI. But we will start using that more in our external communication. We just need to make sure that everything is kind of consistent and all the definitions are lined up and so forth. But it's clear that if you look at the nicotine pouch category, it continues to be by a wide margin, the kind of next generation product category in the U.S. market that shows the best growth. And if you look at that particular chain and it would have been

an awful lot of products to 1 consumer. It was 1 chain. But if you look at the ZYN velocities, what we typically see when there are very deep promotions, there hasn't been much effect on ZYN velocities. But we're talking say, like a 3-week period at the end of the quarter that also stretched into the beginning of the second quarter. But I don't think that, that has affected really the ZYN purchases to a large extent in that particular chain.

Mirza Faham Ali Baig - *Crédit Suisse AG, Research Division - Research Analyst*

Okay. And my second question, I appreciate, I don't know how much you can comment on this, but I appreciate the Board has recommended the offer independently. But are you able to give us a sense of considerations that they will have taken into account and concluded what is a reasonable valuation for a company that was independently very structurally attractive?

Lars Dahlgren - *Swedish Match AB (publ) - President & CEO*

I think it's fairly well spelled out in the recommendation in the press release that includes the recommendation. But as you would expect, and then it is truly long-term projections, but then there is also a balance of opportunities and risks. And also, of course, prior to this bid, the market assessed a certain value in Swedish Match. That was the market value a few days ago. And I'm not saying that, that was the right value. I'm not saying that there was the wrong value either because I refrain from kind of commenting on whether the market is right or wrong, but it's naturally a reference point for the Board in a situation like this. But one out of many. And then as you saw, the solicited financial advisers and including independent experts for fairness opinion but especially they know our business very well, and they have formed their own opinion.

Operator

And we have just a follow-up from Gaurav Jain from Barclays.

Gaurav Jain - *Barclays Bank PLC, Research Division - Research Analyst*

One follow-up question on, let's assume that the deal goes through. So PMI is clearly saying that they will retain all the employees on the production facilities, but they also have a U.S. business or a U.S. headquarter. So is it that you will be commercializing all their future NGP plans? Like how does this exactly work for Swedish Match?

Lars Dahlgren - *Swedish Match AB (publ) - President & CEO*

I don't want to speculate on the details in the potential combination. I think, as I said in earlier markets, it is a very positive kind of overall message in terms of that what PMI is seeing here is a combination with great growth prospects and adding and broadening the portfolio [reduced-risk] product, it's not a cost synergy case. But I think it's premature to go into details of the more exact office locations and so forth. But generally, they expressed clearly that they want to keep the Swedish Match organization.

Operator

And we have another question from Rashad Kawan from Morgan Stanley.

Rashad Kawan - *Morgan Stanley, Research Division - Equity Analyst*

I have just 2 on cigars. One, can you just give us an update on the production issues you're facing there? I mean have things started to improve at all? Is it all supply-related issues that you're seeing? Or are you seeing any changes in demand or consumer behavior there? And then just on the deal, obviously, the press release mentioned that PMI has no plans to divest the Lights business. I presume, obviously, to your point earlier, the

intention will be to sell cigars eventually. But wondering if the deal does go through, would you look to wait for more clarity on SE designations as part of PMI? Or do you expect to be more on the front foot in terms of the investment? I mean, anything you can share there would be helpful.

Lars Dahlgren - *Swedish Match AB (publ) - President & CEO*

When it comes to the cigar separation, I mean, Swedish Match is and will be for at least the near future an independent company and the strategic intent of the Board of Swedish Match is to separate the cigar business. At the same time, the plans to list the cigar business aiming for the second half of this year, as you all know, have been suspended, which means that it's also not expected to happen in the near future. So I think we have the luxury of time here, so to say, to see how things evolve.

And when it comes to the business as such, there are a few moving pieces here. There are certain input material that is particularly, it's more of a constraint for our HTL portfolio. Then there have been some production output in terms of getting the productivity up fully for natural leaf cigars, which has actually improved quite a bit. So that looked clearly better towards the end of the first quarter than the situation we had earlier. At the same time, we see on MSA data, quite a bit of category softness in Q1. I think the number is down 10% year-on-year. However, IRI data indicate roughly half of that. So I think we have some inventory movements as well. So it's a little bit hard to -- which is not uncommon for the cigar business for as most of you know there are a little bit more moving pieces than some of our other business too, and it's not as good visibility. And so we'll have to see how things evolve going forward. But when it comes to the input material, that is more of the timing there is more towards the end of this year when we hopefully should be able to leave that situation fully behind us.

Operator

And as there are no further audio questions, I'll hand it back.

Emmett Harrison - *Swedish Match AB (publ) - SVP of IR & Corporate Sustainability*

Okay, then we thank you all for listening and the release of our second quarter report will be on July 22. Thank you.

Operator

This concludes our conference call. Thank you all for attending. You may now disconnect your lines.

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