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PRESENTATION

Operator

Ladies and gentlemen, good morning. My name is Abby, and I will be your conference operator today. At this time, I would like to welcome everyone to the Radware conference call discussing first quarter 2022 results, and we thank you all for holding. As a reminder, this conference is being recorded on May 3, 2022. (Operator Instructions)

I would now like to turn this call over to Yisca Erez, Director of Investor Relations at Radware. Please go ahead.

Yisca Erez

Thank you, Abby. Good morning, everyone, and welcome to Radware's First Quarter 2022 Earnings Conference Call. Joining me today are Roy Zisapel, President and Chief Executive Officer; and Guy Avidan, Chief Financial Officer. A copy of today's press release and financial statements as well as the investor kit for the first quarter are available in the Investor Relations section of our website.

During today's call, we may make projections or other forward-looking statements regarding future events or the future financial performance of the company. These forward-looking statements are subject to various risks and uncertainties, and actual results could differ materially from Radware's current forecast and estimates. Factors that could cause or contribute to such differences include, but are not limited to impact from the COVID-19 pandemic, general business conditions and our ability to address changes in our industry, changes in demand for products, the timing in the amount of orders and other risks detailed from time to time in Radware's filings.

We refer you to the documents that company files and furnishes from time to time with the SEC, specifically the company's last annual report on Form 20-F as filed on April 11, 2022. We undertake no commitment to revise or update any forward-looking statements in order to reflect events or circumstances after the date of such statement is made.

I will now turn the call to Roy Zisapel.

Roy Zisapel - Radware Ltd. - Co-Founder, CEO, President & Director

Thank you, Yisca, and thank you all for joining us today. I'd like to begin our call by highlighting the news we released this morning, introducing SkyHawk Security, which is a spinoff of our Cloud Native Protector business. This spinoff is a strategic step in the cloud services initiatives that we announced a couple of months ago. Before I get into the details about SkyHawk, first, let me take this opportunity to recap our cloud initiatives.

Given the large market opportunity in front of us in protecting mission-critical applications and data centers against cyberattacks, we made a strategic decision to focus our investments and accelerate our growth in the cloud security as a service space. In addition to the SkyHawk spinoff, we've taken several other important steps in delivering on this initiative.

First, we acquired SecurityDam, our cloud DDoS scrubbing center provider, to leverage assets and synergies and deliver better service to our cloud customers. During the first quarter, we successfully completed the integration of SecurityDam.

Second, we recently increased the cloud service capacity of our global network to 10 terabit per second. This quarter, we are once again working on expanding our capacity and network footprint to meet incremental demand being driven by the growing volume of cyberattacks and the growth in our customer count.

Third, we are expanding our innovation center in India to drive cybersecurity research and development as well as service delivery excellence. Together with our Israeli R&D site, we are focusing on cloud innovation. As part of these innovation efforts, we recently launched Radware SecurePath, a game-changing new cloud application security architecture. Radware SecurePath is designed to deliver on our customers' need for consistent, high-grade security. It offers centralized security management for applications deployed across multi and hybrid cloud environments. Its unique out-of-path deployment options removes the need for any in-line component from the data path to reduce complexity and reduce latency, eliminate routing changes and increase availability.

Finally, as I mentioned earlier, today we announced the launch of SkyHawk Security. Running as a separate entity, SkyHawk will have the ability to operate with even greater sales, marketing and product focus as well as speed and flexibility. Tiger Global Management is making a \$35 million investment in SkyHawk, and together, we intend to scale and strengthen SkyHawk's position and unlock even more security value for customers.

Cloud Native Protector delivers a comprehensive view of the cloud security posture and uses machine learning algorithms to provide misconfiguration detection, compliance assurance and malicious activity alerts. It detects cloud-native threats in real time and provides automatic detection and response.

Our commitment and focus on our cloud business is reflected in our first quarter financial results. Revenue in the first quarter grew 10% year-over-year, driven by our cloud and product subscription business. We also recorded double-digit year-over-year growth in both operating income, which increased 28%, and earnings per share, which increased 11% to \$0.19.

Several noticeable cloud application security wins contributed to our first quarter results. We closed a large cloud web application and bot management deal with a multinational Fortune 500 company in the financial industry space. This company is responsible for thousands of public-facing websites on behalf of its clients, websites that were under constant attack. This financial service leader was looking for new solutions due to the lack of automation, efficacy and visibility in its current deployment. Our win was a cross-sell deal from a very large DDoS win we had a couple of quarters ago.

We also signed a cloud DDoS deal with a global system integration and information technology company that wanted to secure their infrastructure against attacks in several key geographies. The company was looking for a solution provider with a large global presence that could deliver a best-in-class cloud DDoS solution. We won this deal with our partner, Airtel.

DDoS attacks were front and center last quarter, more than doubling compared to the first quarter of 2021. This heightened cyber environment also led to some large first quarter wins. For example, we won a large DDoS deal with a major brand known for its global communication and collaboration solution. This customer network increased massively in the last couple of years, and as a result, it became a target for hacking attempts. They needed more granular mitigation for their dozens of global data centers, and we proved our protection capabilities. This is the first deal we closed with Presidio, a new partner that we announced in the first quarter.

The continued demand for more powerful DDoS mitigation led us to develop and launch the industry's first terabit DDoS mitigation platform, our DefensePro 800. The platform offers enterprises and service providers state-of-the-art protection and performance built to handle ultra-high bandwidth demands and deliver next-generation connectivity for emerging environments.

Our development and innovation not only continue to help us close noticeable deals, but also earn industry recognition. Radware recently received 2 Cybersecurity Excellence Awards. Our application protection-as-a-service-solution, which includes cloud-based WAF, bot management, API security and DDoS protection, was a silver winner in the application security category. And our Cloud Native Protector was a gold winner in the Cloud Workload Protection category.

Industry analysts also continue to recognize Radware as innovator in the industry. In its SPARK Matrix analysis, Quadrant named Radware the Technology Leader for bot management for the second year in a row as well as the leader in the WAF market.

In summary, I'm very pleased with the strong start of the year. We have made great progress on our cloud initiative where we are laser-focused on execution. We just announced the spinoff of SkyHawk. We acquired and successfully integrated SecurityDam. We continue to innovate and develop cloud solutions and grow our cloud services footprint to ensure our customers are protected against a mounting number of cyberattacks.

I want to take this opportunity to thank our employees around the world for their contribution in achieving another successful quarter.

As most of you know, a few months ago, we announced Guy Avidan as our new CFO. I want to welcome Guy to his first earnings call with Radware. Guy?

Guy Avidan - Radware Ltd. - CFO

Thank you, Roy, and good day, everyone. I'm excited to be here today for my first earnings call at Radware. I look forward to meeting many of you at upcoming investor events. I'm pleased to provide the analysis of our financial results and business performance for the first quarter of 2022, as well as our outlook for the second quarter of 2022.

Before beginning the financial overview, I would like to remind you that unless otherwise indicated, all financial results are non-GAAP. A full reconciliation of our results on GAAP and non-GAAP basis is available in the earnings press release issued earlier today and on the Investors section of our website.

We started 2022 on a high note with 10% growth in revenue for the first quarter 2022, reaching \$73.7 million in revenue compared to \$66.8 million in the same period of last year. Revenue growth was driven primarily by our subscription business.

Total ARR increased 9%, reaching \$192 million in the quarter and was also driven by cloud and subscription ARR, which grew 20% year-over-year.

Looking at geographies. First quarter 2022 revenues in the Americas totaled to \$29.5 million, a decrease of 12% versus the first quarter of 2021. Trailing 12-month revenues in the Americas increased by 5% over the previous period.

We saw strong growth this quarter in EMEA and APAC. EMEA grew by 33% to \$28.1 million, and APAC grew by 34% compared to Q1 2021, reaching \$16.1 million. For the trailing 12 months, revenue in EMEA increased 30% and APAC, 12%. Americas and EMEA account for 40% and 38% of total revenue, respectively, and APAC account for the remainder 22% of total revenue.

I will now discuss expenses and profit. Gross margin in the first quarter 2022 was 83.2% compared to 82.4% in the same period in 2021, an expansion of 80 basis points. Our gross margin improved mainly the result of SecurityDam integration offset by higher costs related to cloud infrastructure and supply chain.

Operating expenses in the first quarter of 2022 increased by 9% to \$51.7 million compared to the same period in 2021 due to additional head count, including SecurityDam personnel joining our R&D team, and related costs as well as increase in marketing and travel costs as COVID impact decreased. We continue building out the company's infrastructure to support a sustainable revenue growth given the significant market opportunities we see in front of us.

Operating income grew by 28% to \$9.6 million compared to \$7.5 million in Q1 2021, and operating margin increased by 180 basis points to 13%. Increase in operating margin is a result of revenue growth, reflecting our leverage in the model.

As we highlighted in previous calls, the declining yield on marketable securities and the positive impact on financial income, which decreased from \$1.9 million in the first quarter of 2021 to \$800,000 in the first quarter of 2022. We expect the financial income to remain at the same level in Q2 2022.

Earnings per diluted share for the first quarter 2022 increased 11% year-over-year to \$0.19, resulting from the gross and operating margin improvement.

Turning to the balance sheet and cash flow items. Cash flow from operations in Q1 2022 was negative \$10 million compared to positive cash flow from operations of \$16 million in the same period of last year. Cash flow from operation was impacted mainly by \$21 million extraordinary tax payment that will partially return in the future. We expect to generate positive and healthy cash flow from operations in the remaining quarters of 2022.

During the first quarter, we repurchased shares in the amount of approximately \$23 million and completed our full 2021 \$80 million share buyback plan. We ended Q1 2022 with approximately \$397 million in cash and deposits and marketable securities.

Before turning to our guidance, I'd like to join Roy in welcoming Tiger Global as an investor in SkyHawk. We plan to capitalize on the large addressable and fast-growing market opportunities ahead of us. SkyHawk, like EdgeHawk, which is focused on carriers' Edge security market, will operate as a separate company, catering to markets that are adjacent to Radware's core business.

To report on the progress of the Hawks companies, we will provide aggregated update on our quarterly investment predominantly based on R&D expenses during future earnings calls.

I'll conclude my remarks with guidance. For the second quarter of 2022, we expect total revenue to be in the range of \$75 million to \$76.5 million. We expect our operating expenses to be between \$52.5 million to \$54 million. With that, Q2 2022 diluted earnings per share is expected to be between \$0.19 and \$0.20.

I'll now turn the call over to the operator for questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) We will take our first question from George Notter with Jefferies.

George Charles Notter - *Jefferies LLC, Research Division - MD & Equity Research Analyst*

I guess, I would love to hear more about the rationale behind the spinoff of the Cloud Native Protection business. Maybe you could kind of give us more on that in terms of what's in it for your customers? How does it affect Radware's financials? I'm interested in how many employees are moving over? And then how do you plan on kind of showing shareholders the value of that investment going forward?

Roy Zisapel - Radware Ltd. - Co-Founder, CEO, President & Director

Okay. Let me start with the rationale. So as we mentioned, the Cloud Native Protector is focused on public cloud security. The customers, the main customers we have for this product line are different than the large enterprise and carriers that we have in the other product lines of Radware customers, and also the competitors are a different set of competitors.

As we've mentioned in our cloud initiatives, we really want to be very, very focused on cloud Security as a Service, the DDoS, the WAF, the API, the Bot security for all our customers. And therefore, we thought it makes a lot of sense for us to spinoff the public cloud security with its different set of focus areas. This will enable us to attract start-up based talent to the SkyHawk company and to run it very similar to a fast-growing, somewhat VC backed company. We think that would be the best in growing the business, providing our customers with faster development and better product line down the road.

So that's on the, I would say, on the logic behind it. It drives more focus on the Radware, on the core Radware side, and it allows us to run faster on the public cloud security market.

Regarding how will we show it in future financials, Guy, would you like to take it?

Guy Avidan - Radware Ltd. - CFO

Yes. So on the earnings call, we will talk about the Hawks as an aggregated, so we will disclose the expenses, actually, the investment in both SkyHawk and EdgeHawk. And on the annual, we will open it as a segment that you'll be able to see the complete P&L of the Hawks Group.

George Charles Notter - Jefferies LLC, Research Division - MD & Equity Research Analyst

Got it. Okay. And then how does this change your head count, just out of curiosity? And then also, what was the head count in the company at the end of the quarter?

Guy Avidan - Radware Ltd. - CFO

The head count at the end of the quarter was at 1,264. It doesn't really change the head count as of today. In the future, as Roy mentioned, we expect to accelerate the growth on SkyHawk.

Roy Zisapel - Radware Ltd. - Co-Founder, CEO, President & Director

And around 30 people moved from Radware to SkyHawk, predominantly in R&D and product management and delivery functions.

George Charles Notter - Jefferies LLC, Research Division - MD & Equity Research Analyst

Got it. Okay. Great. And then the step-up in head count, I assume, is in part driven by the SecurityDam integration? Is that correct?

Guy Avidan - Radware Ltd. - CFO

Right. So out of -- if you compare it to December 31, out of the 121 growth, close to 70 is attributed to SecurityDam.

Operator

We will take our next question from Alex Henderson with Needham & Company.

Alexander Henderson - *Needham & Company, LLC, Research Division - Senior Analyst*

So am I reading the balance sheet right, that you guys are contributing \$30 million in cash to this operation?

Roy Zisapel - *Radware Ltd. - Co-Founder, CEO, President & Director*

No. We are not investing in that operation. So I think the balance sheet, what you see -- what you see there is -- what Guy mentioned as the tax, payments and the buybacks. Those are the main -- and the SecurityDam acquisition. Those are the impact on the balance sheet.

Alexander Henderson - *Needham & Company, LLC, Research Division - Senior Analyst*

Okay. I just wanted to clarify that. Just some basic groundwork upfront U.K. -- Ukraine Russian exposure, would you quantify whether you have any -- do you have any receivables or any other issues on that front that you need to write down?

Guy Avidan - *Radware Ltd. - CFO*

No, nothing to write down.

Alexander Henderson - *Needham & Company, LLC, Research Division - Senior Analyst*

Right, so no exposure on revenues, no exposure on receivables. And has there been any change in the EMEA environment either in terms of expected pipeline or closure rates or anything to that sort as a result of the macro contusion to the geography?

Roy Zisapel - *Radware Ltd. - Co-Founder, CEO, President & Director*

On EMEA, we see very good business trends. So we saw some activity in the neighboring countries around cybersecurity at the nation level. Obviously, people are very concerned. But in general, we didn't see interruption or any other implication on the business activity in EMEA in general.

Alexander Henderson - *Needham & Company, LLC, Research Division - Senior Analyst*

Broadly speaking, if you look at your pipeline of business globally, are you seeing any change in the condition in that? Or is it improving as a result of increased cyber threat, or slowing down as a result of macro considerations?

Roy Zisapel - *Radware Ltd. - Co-Founder, CEO, President & Director*

Relatively growing in the same pace, we would say. Nothing specific.

Alexander Henderson - *Needham & Company, LLC, Research Division - Senior Analyst*

Okay, so no real changes in that context. Okay. Great. Going back to the operations a little bit. The pricing environment has been one of significant price increases across most of the networking space. I realize that you guys are more software-oriented, and particularly, that's where a lot more of your growth is coming from. But have you seen any changes in the pricing environment that are helping you gain some share or creating some opportunity? And are you doing anything on pricing?

Roy Zisapel - Radware Ltd. - Co-Founder, CEO, President & Director

Yes. We didn't see major changes in the pricing environment. We did execute a single-digit price increase in select models towards the end of the quarter, as I think we've discussed last time. Obviously, if at all, it takes some time for that to get into revenues as there's some 90 days initial period and then also it depends on specific customer contracts and mix, et cetera. However, we did make some price list increases. It's not affecting yet Q1, and I don't think there will be any significant impact on Q2.

Overall, we didn't see major pricing difference towards the market. We obviously see a different pricing environment in the components, which increases our costs. But that's how I would characterize the current environment.

Alexander Henderson - Needham & Company, LLC, Research Division - Senior Analyst

Okay, and then one more question in terms of partnerships, particularly the Cisco partnership, which is obviously your largest. Can you give us an update on what's going on with partners, and whether you're seeing an acceleration of share within those partners, particularly Cisco? How is that contributing to the numbers here?

Roy Zisapel - Radware Ltd. - Co-Founder, CEO, President & Director

Yes. So I think a couple of points I would like to highlight versus previous quarters. So first, I think we continue to advance on the strategic level with our key partners and embed more of our offerings into their portfolio. I believe this will be seen in coming quarters also in the market. That's one.

Second, we are also now attracting some of their key channels to us. So based on those relationships of Checkpoint and Cisco, we're able to go to key resellers in the market and create a very good incentives to represent Radware and the full portfolio. I think, for example, Presidio, that I've mentioned in my comments, is a very good example. Presidio is one of North America's biggest Cisco channels. Based on our relationship and their ability to get credits for Radware sales through Cisco, they also took our offering directly end-to-end, and we've issued a very strong press release and a very nice activity in the market together with them.

So now we are starting to capitalize on those OEM relationships also to build on the broader channel. This initiative is it's still early, but I think it's another promising capability that we gained through those partnerships.

Alexander Henderson - Needham & Company, LLC, Research Division - Senior Analyst

Does the extreme length of time to deliver other products in the Cisco suite or other systems companies suite in those partnerships have an impact on the timing or the scale of what you're selling into them either because people choose to go with your products, considering they're available, and shippable and that increases their attractiveness to a salesman? Or because negatively, they can't sell the rest of the systems that are involved with a project, and therefore, delay the timing on your products? Any impact either way as a result of supply chain pressures on the partners?

Roy Zisapel - Radware Ltd. - Co-Founder, CEO, President & Director

Yes. So I think the fact that we have those cloud solutions, I think that's a positive for our partners because put aside our ability to deliver also the appliances, their mindset is that appliances are now our product, order is hard to supply, to sell, and it's better to move to cloud solutions to accelerate the ability to invoice and complete projects. So the fact that we are well represented with our cloud solutions in Cisco and Checkpoint, I think, helps us in that end.

On the other hand, I can tell you that although we can supply equipment, we did see very few, I don't want to -- I didn't -- we didn't want to highlight that. I don't think it impacts our results in a significant manner. But since you've asked, the fact that large infrastructure projects are delayed, sometimes means that we cannot supply also ours because if our security products are sitting on top of switches and routers, and those switches

and routers are not going to supply in the next 6 months, the customer doesn't want to accept also the security appliances because there's nowhere to connect them to.

So we did see some very large, I would say, infrastructure projects, that phenomena. But overall, we don't see the impact. Our ability to ship products as well as the growing scope of our cloud services is assisting us a lot in navigating those times.

Alexander Henderson - *Needham & Company, LLC, Research Division - Senior Analyst*

All right. So is it a net positive or a net negative?

Roy Zisapel - *Radware Ltd. - Co-Founder, CEO, President & Director*

I think for the channel -- for our partners, these are positive what we can do for them.

Operator

We will take our next question from Tavy Rosner with Barclays.

Tavy Rosner - *Barclays Bank PLC, Research Division - Head of Israel Equities Research*

Can you hear me okay?

Roy Zisapel - *Radware Ltd. - Co-Founder, CEO, President & Director*

Yes.

Tavy Rosner - *Barclays Bank PLC, Research Division - Head of Israel Equities Research*

Great. Just one last follow-up for me on the SkyHawk deal. I'm curious, why taking an external investor when you have quite a significant cash position? So I'm just wondering, from your perspective, what do you see Tiger adding to the operation in terms of value contribution?

Roy Zisapel - *Radware Ltd. - Co-Founder, CEO, President & Director*

Okay. I think from our point of view, it achieved several key points. One, we wanted to make sure that the Hawks, EdgeHawk and SkyHawk. In this case, SkyHawk, is really seen by talent, by customers as a real stand-alone start-up company. And for that, we wanted to have a Tier 1 VC to join us. That's one.

Second, I think it's also important for our shareholders to get this external valuation indication. We could, of course, continue to invest and finance it from our own resources, but I believe this highlights the current expectation of Tier 1 VCs from what this business can become to and definitely the valuation they see today. So I think it's also important for our shareholders to get this external validation.

Tavy Rosner - Barclays Bank PLC, Research Division - Head of Israel Equities Research

Okay. Understood. And then touching on the U.S. market. I mean, you mentioned a decline this quarter versus last year. But you did mention on trailing 12 months it was growing mid-single digits. When you look at your pipeline for the coming quarters, how comfortable you are about growing the U.S. business?

Roy Zisapel - Radware Ltd. - Co-Founder, CEO, President & Director

So we expect all our regions, and obviously, the U.S. to grow on a yearly basis. There might be fluctuations in specific quarters, but we do believe North America will continue to grow this year as well.

We do want to see an accelerated pace of growth there. While we highlighted the last 12 months as a 5% growth, there's definitely an opportunity for us to do better there, and we are focused on achieving that.

Tavy Rosner - Barclays Bank PLC, Research Division - Head of Israel Equities Research

Great. Got it. And then lastly, on subscription. Can you give us a sense of how much comes from new business versus converting some of your existing on-prem customer?

Roy Zisapel - Radware Ltd. - Co-Founder, CEO, President & Director

In our cloud business, there's very little migration from an on-prem to cloud. So if a customer, for example, was our DDoS customer in the on-prem, we will generally complement that implementation with a cloud. DDoS on-demand to create what we call the hybrid, the cloud hybrid DDoS offering, which is, by far, the strongest, most protecting DDoS solution out there. And you see our largest customers are utilizing this hybrid architecture. So that's on DDoS.

And in cloud application security, both API, WAF, we predominantly play only in the cloud security-as-a-service play. We are not moving customers with on-prem WAF to the cloud, so there's no cannibalization or movement to that sense. So all the businesses, new deployments into the cloud environment.

Operator

And we will take a follow-up question from Alex Henderson with Needham & Company.

Alexander Henderson - Needham & Company, LLC, Research Division - Senior Analyst

So I'm looking at the numbers for the full year, and I know you don't want to really give guidance for the full year, but they're kind of all over the map. The revenues range is pretty tight, but on the EPS side, there's a bunch of people who -- in kind of the mid-70s, and estimates as high as \$1 per share.

Can you characterize how you're thinking about the full year? Maybe not necessarily giving specific guidance, because I know you don't want to do that, but what are you thinking in terms of this year in terms of the overall environment on spending versus the overall environment on growth? If we assume kind of mid-singles to high-singles growth for the year or 8% to 10%, or whatever you want to talk to. What are you expecting in terms of the margin side of the equation to help us bring that very wide display of numbers into a tighter range?

Guy Avidan - Radware Ltd. - CFO

Again, I think we discussed it also in previous calls. The leading indicator for our CAGR is actually the ARR. So as long as it's growing 8%, 9%, that's pretty much going to be our growth in the coming quarters. We still see a very healthy market, a lot of opportunities in new investment and expansion of investment in infrastructure. And definitely, we will enjoy this expansion.

Regarding OpEx, again, we're seeing a lot of opportunities. And as a result, we will add more head count both in sales and marketing and R&D to capture these opportunities. So EPS should not improve dramatically.

Alexander Henderson - Needham & Company, LLC, Research Division - Senior Analyst

Okay. So just to put that in context, 2021 was around \$0.81. I think there was kind of a bias to actually a little bit of contraction prior. And now you're -- have edged up a little bit in both the March and June quarter, so kind of flattish EPS for the year is kind of consistent with that commentary?

Guy Avidan - Radware Ltd. - CFO

Again, we're not guiding for the year, so this is, I'd say, too much information. I think what I said is -- it should be enough.

Alexander Henderson - Needham & Company, LLC, Research Division - Senior Analyst

I can't blame a guy for trying.

Operator

And there are no further questions at this time. Mr. Roy Zisapel, I turn the call back over to you.

Roy Zisapel - Radware Ltd. - Co-Founder, CEO, President & Director

Thank you, everyone, for joining us, and have a great day. Thank you.

Operator

And this concludes today's conference call. You may now disconnect.

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