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PRESENTATION

Peter J. Arment - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Okay. Good morning, everyone. Thank you for joining us here today. My name is Peter Arment and I'm the senior aerospace and defense analyst here at Baird. We're very pleased to have with us the management team of Raytheon Technologies.

This is a fireside chat. (Operator Instructions)

And from Raytheon, we have Neil Mitchill, who's Chief Financial Officer.

And before we get started into the fireside discussion, Neil's just going to make a few opening comments. And of course, making any important forward-looking statements he has. So Neil, thank you and welcome.

Neil G. Mitchill - *Raytheon Technologies Corporation - CFO*

Thank you, Peter and good morning. Like I said earlier to you, it's too bad we couldn't do this in person. I was really looking forward to it. I think by next year, we should be in much better shape, and I look forward to doing this in Chicago.

So good morning, everyone. Before I get into a few opening comments, let me just make a couple of obligatory remarks here. I need to let you know that I may make some forward-looking statements, such as comments on future plans, our objectives and expected performance.

These are, of course, just subject to risks and uncertainties that could cause our actual actions or results to differ greatly. And you should consult our SEC filings for description of those risks and uncertainties. So with that out of the way, let me just make a couple of opening comments, Peter, and then I'll turn it back to you for some questions.

So let me start off by reiterating that I was very pleased with our Q3 results and where we saw 10% organic sales growth. We had \$1.26 of adjusted earnings per share, which was above our expectations and generated \$1.5 billion of free cash flow. So very strong and puts us in a good position to finish the year in line with our expectations.

During the quarter, we also bought back \$1 billion of our stock, bringing us to \$2 billion through the first 9 months of the year, meeting our commitments that we had laid out as we went through the second quarter.

From a financial outlook perspective, as we look to close out 2021, we did adjust our full year sales outlook, and we now see approximately \$64.5 billion of sales, primarily due to isolated supply chain pressures and the lower 787 build rates that we discussed on our call a couple of weeks ago. However, given our strong performance on cost control, synergy capture and program execution on a year-to-date basis, we did raise and tighten our adjusted EPS range to \$4.10 to \$4.20 per share. And we raised the low end of our free cash flow outlook and now expect the full year free cash flow to be approximately \$5 billion. That's more than twice the free cash flow from a pro-forma basis for 2020.

So sitting here today, I continue to remain confident in this outlook. But let me give you a little bit of color, Peter, just before we get into the questions on some of the businesses on the defense side. We're happy with the fiscal '22 budget request. It's in line with our expectations. And as

we've said, this defense spending rather is non-partisan. We're encouraged to see Congress supporting plus-ups to the President's budget, that are also aligned with our businesses and our investments in technology and the threat environment.

So I feel confident that we'll continue to grow our defense businesses over the next several years. We exited the third quarter with a robust defense backlog of over \$65 billion, and we continue to see strong bookings in the third quarter. And on a full year basis for this year, we expect the book-to-bill at RIS and RMD to be over a 1.0.

On the commercial side, again, we continue to be optimistic about the recovery. Commercial air traffic continued to recover during the third quarter. We expect that to continue here in the fourth quarter, even despite some regional impacts from various COVID variants. Obviously, the recovery of the long-haul international traffic lagged expectations earlier this year, but we've seen those borders start to reopen, and we are confident that, that will support the Collins business, in particular, as the widebody aircraft get back to conducting their routes.

We're keeping an eye on the vaccination rates like everyone. We've got just about 50% of the world with 1 or 2 shots. So that's a positive and we believe the long-term fundamentals of the recovery remain intact. So let me just spend a second on next year.

So I'm not going to get into specifics around our guidance for '22, I do want to make a couple of comments. First of all, don't expect any significant surprises at the segment level related to sales and operating profit relative to the current Street expectations. We expect the commercial aerospace recovery to continue, which is going to drive the aftermarket as well as higher OE deliveries, both at Collins and at Pratt. That will, of course, bring some higher negative engine margin.

We also feel good about our ability to grow the defense franchises, with that backlog that I just mentioned and the continued support for the defense budget, both domestically and internationally.

So in addition to some higher intersegment profit eliminations as we grow through the commercial recovery, you'll see some headwinds below the segment operating profit line as we continue to invest in our digital transformation activities, our merger synergy projects. And then along with corporate sponsored R&D, our LTAMDS spend will also continue in 2020 as the program continues to achieve some program milestones.

And finally, we're anticipating some tax headwinds next year given the legislation that's being discussed in D.C., but we'll need to see where that lands as the year progresses here.

So overall, very confident in our future. We've got a balanced portfolio, strong franchises. We operate in resilient markets. We have great technology, and we're continuing to invest in innovative technologies across the portfolio to provide new solutions to our customers. And our continued focus on operational excellence positions us well, I believe, to deliver on the 2025 goals that we laid out at our Investor Day. So Peter, back to you.

QUESTIONS AND ANSWERS

Peter J. Arment - Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst

Great. That's a terrific rundown, Neil, we appreciate that. So Q3 earnings was really for a lot of defense companies more dynamic than usual. I think if we would go back a little bit earlier, I think it was back in May, you had your '22 -- you put out some 2025 targets. Maybe you could just provide a little color on what you think about your defense portfolio kind of matching up to those original targets that you laid out back then.

Neil G. Mitchell - Raytheon Technologies Corporation - CFO

Yes. Certainly, the last couple of weeks were a little bit dynamic on the defense side. Let me first reaffirm, Peter. We are confident in our 2025 targets for the whole company and the defense businesses in particular. As I said in the opening comments, we continue to be happy with where budgets are going on the defense side. We see them growing slightly, probably keeping up with inflation, maybe a little bit better. That's domestically.

Internationally, there continues to be a lot of demand for our products. And I think you know that our portfolio is pretty well balanced between domestic and international customers.

So we believe that our defense businesses will grow next year and then will continue to grow as we go through the next several years. No change to the 2020 to '25 CAGRs that we put out there at Investor Day for RIS and RMD, we expect RIS to grow 4% to 5% and RMD 3% to 4%.

So I still see that growth today. Both businesses have -- will have book-to-bills of greater than 1.0 for '21. So that positions us well to deliver on that backlog, and we've had some great program wins. So we plan to deliver next year on the SM-3, SM-6, NGI, LRSO, AMRAAM and obviously, a number of classified awards that I can't get into the details.

But our portfolio, Peter, is very diversified. It's a platform-agnostic portfolio. To give you an example, at RIS, we've got over 5,000 -- over 5,500 contracts that we're operating under today. So we're a systems integrator. I think we've got our chips spread across the table quite well. We're well aligned with the threat environment and no single program is going to be a material driver. Of course, at Pratt & Collins, same thing. We're across a number of systems there and programs, and we've calibrated the F135 volumes into our Investor Day outlook that we talked about in May. So I don't expect any drama there.

Peter J. Arment - Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst

Great. That's a good place to run down on defense. On the commercial side, maybe can you update us your thoughts on -- just your latest on the commercial recovery, how things are looking domestically and then also on the international front and kind of some of the key pieces there.

Neil G. Mitchell - Raytheon Technologies Corporation - CFO

Sure. On the international front, very happy to see folks flying from Europe and other countries now into the United States. So that started this week. We continue to be very optimistic about the commercial aero recovery, continue to see ASMs grow. We saw a 25% to 30% sequential growth in Q3, 5% or so sequential in domestic routes, but 65% internationally. So that's starting to open up.

As we've talked a lot about, our markets are different for Collins and for Pratt. Pratt is very narrowbody focused, and we're seeing good results there so far. That should continue as we get into next year and the out years. And at Collins, good narrowbody, good bizjet, but we also will expect to see higher 737 next year. We should see 787 start to pick up again. We're at a production rate of about 2 now. We saw Boeing come out with that.

So a lot of opportunity going forward. It will be a little bit choppy, I think, depending on the geography, depending on the airline actions. And hopefully, there won't be any major COVID interruptions, but we're continuing to monitor that as well. I think I would just say we're strongly positioned on all of the major platforms. Obviously, 737 MAX is unique to Collins, but A220, A320neo, Collins and Pratt both benefit from that. 787, A350, Collins has a strong position. So we're in the right place, and I think we expect a good recovery.

Maybe just a comment or two, Peter, on GTF. The engine is performing very, very well. The platform of engines have flown nearly 11 million hours with a dispatch reliability, well over 99%. The fleet remained highly utilized even through the pandemic, so, we're talking 87%, 88% utilization. And even the V fleet is at 70% utilization. So -- and we expect that to grow.

So I put all that together, -- We clearly see the underlying demand. How that kind of phases through next year, we'll see, especially with those international routes, but certainly see a lot of tailwinds with respect to the commercial recovery.

Peter J. Arment - Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst

And maybe just staying on the same kind of question, but can you remind us kind of the -- where you may be in sync on just the MAX production and just kind of how that -- how you expect to kind of flow there because there's just been a lot of different suppliers at different rates?

Neil G. Mitchill - Raytheon Technologies Corporation - CFO

Yes. So you'll recall at the beginning of the year, we had delivered a lot of product to Boeing and so they had that in inventory. With that inventory, we've started -- they've started to burn that down. We're starting to deliver again to them in the third quarter, here in the fourth quarter a little bit higher.

And as I said on our third quarter call, I do expect by the middle of next year, we should be pretty much in sync with Boeing's rates of production. So it will continue to be a tailwind for us. We're obviously in lockstep with our customer there. And I think as we see that activity ramp up so will provisioning and the spare parts that go with that fleet.

Peter J. Arment - Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst

Got it. Okay. That's helpful. Maybe let's focus on the commercial market -- aftermarket for a second. We know the aftermarket is one of the large drivers at Raytheon. Maybe can you explain just how you see some of the key drivers going forward? Maybe your thoughts on the cadence of the shop visits and what else maybe we should be watching going forward.

Neil G. Mitchill - Raytheon Technologies Corporation - CFO

Sure. As we've been talking about this year, narrowbody has been the primary driver for both Pratt and Collins as well as bizjets, general aviation and the helicopter markets in our Pratt Canada business. Those have been very strong for us, so that's nice to see. Airfreight continues to be very strong. In fact, on a seasonally adjusted basis, that's above 2019 levels. And so keep in mind, 40% of Pratt's PW2000 and 4000 fleet support cargo missions. And so that's been a nice tailwind as well.

Widebody is the part that Collins is not seeing a lot of activity. There's still some there, obviously. But 40% to 45% of Collins 2019 aftermarket was comprised of widebody related aftermarket sales. And so that's the key piece that we'll be watching to see customer behaviors as we exit this year and begin next year as they prepare to bring those routes back. I think -- I'll be back in January, we'll provide a little bit more color around 2022's outlook there. But the timing of when we see that pickup is really going to be the driver for Collins next year in terms of how much of that aftermarket we see and at what point, whether that starts first quarter, middle of the year or later.

Clearly, on the European routes, we expect transatlantic routes to open up. You're seeing that now. It's Asia that I think could be a little bit further behind, but we'll have to continue to monitor that.

Peter J. Arment - Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst

That's great. Just circling back to kind of the Investor Day targets that you kind of talked about, you gave us a lot of financial targets back in May. Maybe just specifically on those updates of 2025, you talked about kind of sales margins, cash expectations, maybe just because there's a lot of investors who may be watching here, they may not be familiar with some of those targets. That would be helpful, I think if you could maybe just give us a little overview there.

Neil G. Mitchill - Raytheon Technologies Corporation - CFO

Yes, sure. Happy to do that. So when we did our Investor Day back in May, we felt it was really important to put some longer-term targets out there, given the great uncertainty that was unfolding in the near term. And so -- with that, we were able to put our plans together. And I think since we'll be well past, hopefully, the COVID impacts here, I feel very good about the 2025 outlook.

And so just to reaffirm, we had talked about top line growth of about 6% to 7% CAGR between 2020 and '25. I see no change to that. I see no change to any of the metrics we've put out there from where I sit today.

As we significantly grow our sales over the 5-year period, that will come with margin expansion, obviously. We talked about over \$5 billion of gross cost takeout, netting down to about \$2 billion. So the volume, combined with the cost takeout, should expand our margins by 550 to 650 basis points by 2025.

And I think most importantly, we put a marker out there for our free cash flow. We expect \$10 billion plus of free cash flow in 2025. And I think as we sit here today, we're seeing good strong cash flow for this year. As I said on the earnings call a couple of weeks ago, I expect that to improve obviously and grow in 2022. And so I'm starting to see that traction. I feel very confident that we'll get to the \$10 billion in 2025 as well.

So excellent progress. No changes to what we had said there. Certainly, the path between here and there will depend on the recovery profile, but we believe that, that underlying demand is there. And by 2025, we're hopefully looking in the rearview mirror of COVID.

Peter J. Arment - Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst

Yes, look, we all look forward to that. And certainly, your \$10 billion free cash flow number got everyone's attention. So we're kind of continuing to march towards that, I think, is obviously really important to the story. Maybe if we just switch over to maybe something a little more near term, you updated our 2021 outlook a couple of weeks ago on your third quarter earnings call. How do you expect to close out the year when you're thinking about -- kind of the momentum that you're seeing there?

Neil G. Mitchell - Raytheon Technologies Corporation - CFO

Sure. Yes. So, as I sort of said in my opening comments, Peter, we did update our guidance, just to reiterate it sales about \$64.5 billion, which is just above the low end of our full year range. We talked about some headwinds, I'll get into that in a second.

Earnings per share of \$4.10 to \$4.20. Still a range on that as we monitor the aftermarket in particular and how that sort of comes in as the year closes out. And then free cash flow, a little higher than we had seen coming out of Q2, as we took our CapEx down a little bit, got some better profit coming from the aerospace businesses. So about \$5 billion, all still hanging together. We've got 1-month of the quarter behind us, everything is sort of in line with our expectations so far.

So nothing to change there. As I talked about and Greg talked about on our earnings call, we did have some sales pressure coming from a few different places. 787 volume was a big piece of it, about \$150 million, all of Collins, obviously. No profit associated with that.

That's all in the aftermarket. Some very isolated supply chain issues at RIS and in Collins at the defense businesses. Again, \$275 million, a relatively small number when you think of \$64.5 billion of sales. We're doing all the things you'd expect to manage the supply chain pressures. We also have some labor challenges because we've got a lot of open reqs. We're looking to hire folks to support our classified programs that has its added challenges as well.

But again, all timing. We did talk a little bit about some Afghanistan headwind, \$75 million. That obviously won't come back, but the rest of this is all timing. I think we're doing all the right things. The team is actively managing the supply chain. So we feel good about closing out the year.

Peter J. Arment - Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst

Great. Just regarding your comment just on the supply chain. How do you feel about that kind of visibility on those supply chain pressures? I mean, you mentioned the team is doing a very good job. And it sounds like you have a good line of sight, but maybe just how are you -- what are you seeing there on the visibility front?

Neil G. Mitchill - Raytheon Technologies Corporation - CFO

Yes. So we've got excellent visibility into our supply chain. We've got about 13,000 product suppliers within the company, across the company, and we've got very active and detailed programs in place to monitor the health of the supply chain to monitor receipts, the timing, and we're providing long signals to our supply chain so they know what products we need. And frankly, I've been really happy with the inventory performance. I talked about that a couple of weeks ago as well.

We're monitoring a handful of suppliers, as we always do. We have a lot of experience with these suppliers, where necessary, we're on site. But I think we've got very good visibility into that, Peter. We know where the obstacles are. We also know from our past experience and the ramps we've gone through already where potential issues may arise. So we're on top of that and being proactive. So I think the team is managing it quite well.

Peter J. Arment - Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst

Let's -- and another area that comes up that is last -- this past quarter, has been around inflation. You've seen how are you dealing with inflation, whether it's on the material to labor side? And then maybe also just related to that is how we think about maybe it's inflation impacting your backlog at all? Just how do we look about that, how that flows through?

Neil G. Mitchill - Raytheon Technologies Corporation - CFO

So good questions here. Obviously, inflation is ticking up. It remains to be seen as to how long-term and permanent that remains. But we've seen some increases in our raw material pricing. Obviously, wage inflation is starting to come up as well.

So from our perspective, we're pretty well protected in the near term. We've got about 90% of Pratt's needs are under a long-term agreement, about 70% of Collins. So on average, I think about 80% for the next several years. So we feel pretty well protected. Those agreements have good protection in place for inflationary pressures.

Obviously, as they get renegotiated, we'll have to see where prices go. But in the near term, I think we're protected. On the defense side, kind of keep in mind, about 40% of the business is cost-plus. And so from that perspective, we're in a good shape. Where we have backlog in many cases as soon as we're awarded something we get on a PO, we're securing products.

So I think we've got that largely mitigated as well. And of course, as we enter into new contracts, so there will be opportunity to price that in.

So will there be some pressures? Yes. Is it manageable? We believe so. And on the labor side, we're going to -- it's a tight market. So we're going to continue to see that pressure. And we'll continue to work productivity to offset the increasing labor inflation across our company.

So it will be to be a headwind for us, but we will do everything we can and we've got the right tools, our core operating principles to put to good work and manage those risks as we see them come up.

Peter J. Arment - Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst

Well, another area where you've kind of been managing risk is also around your kind of the cost control element and what you've been doing, and that was a big part of your margin expansion story. And Greg does a great job on the earnings calls and give us updates on kind of the merger growth synergies and you've been able to increase those a few times.

Maybe you can just give us an update where you are? And then also, I think what would just be helpful, investors is just -- maybe give us a quick reminder of where the history was on Goodrich and Collins because we haven't covered the company a long time. I've seen you exceed those results. And obviously, I think everyone is focused on what the current merger synergies are.

Neil G. Mitchill - Raytheon Technologies Corporation - CFO

Yes. Well, thank you. Yes, obviously, cost reduction is one of our top, top priorities right now. We've done plenty of portfolio realignment. We believe we have the right businesses in our portfolio. And so we are laser focused on driving cost reductions throughout the business, all of our businesses, including our defense businesses. So as you said, with the merger cost synergies, we just took our target up again. We -- for the year, for this year, we expect to see \$700 million of gross cost reduction. That will bring us to nearly \$1 billion since the merger. And we're well on our way to meeting our target of \$1.5 billion, a lot of great work there across lots of disciplines.

Again, we took the opportunity during the COVID situation to really focus on what we could control and cost is something we can control.

The playbook is well written in this area. We, as you pointed out, with Goodrich, which is a long time ago now, we initially planned for \$350 million, \$400 million of synergies. We stopped counting at about \$600 million. And with Collins, we had targeted \$500 million. We expect to realize about \$600 million by the end of this year, which is a year ahead of schedule. So we sort of know the recipe here. We've got a good cross-business unit team in place to drive this. We do monthly reporting, as you'd expect, and keep this very much at the forefront of our priorities for this year and for the foreseeable future.

Peter J. Arment - Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst

That's great. Maybe let's move over to talking about, since you're generating all this cash to capital, capital allocation, what's your thinking around that? How should investors be thinking about capital employment as we go forward into next year?

Neil G. Mitchill - Raytheon Technologies Corporation - CFO

Yes. We're obviously very focused on capital deployment. There's really nothing new to report here on our priorities. We obviously continue to make investments in our business, E&D and CapEx this year will be about \$5 billion of our own money in high growth and high margin areas. We're very much committed to returning \$20-plus billion to our share owners in 4 years following the merger through dividends and share repurchase.

As I said already, we already repurchased \$2 billion of our shares, and we'll continue to be opportunistic as we go through the rest of this year. And we've got about \$6 billion more of share repurchase to do over the next 2 years. And so you'll see us increase our share repo going into the next couple of years to meet those targets. And we're very much committed to the dividend.

So we maintained our dividend through the pandemic. So we're really proud of that, and this year, increased it by over 7%, and we'll continue to grow the dividend as our earnings grow in the future.

So strong balance sheet, a lot of flexibility, and we intend to remain committed to those capital priorities. And of course, over the 2025 -- 5-year period, we'll invest about \$6 billion into the business each year, split pretty evenly between E&D and capital, maybe a little bit more weighted towards E&D, but we're not starving this business. We want to make sure we're investing in those high growth and high return, high-margin areas as we go through the next several years.

Peter J. Arment - Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst

Yes. And unlike other kind of companies coming out of the pandemic with flexible balance sheet and you've got a lot of optionality there. So what -- how should investors think about M&A? I mean, just because it's hard to think about M&A after such a big merger. But -- Are there areas in the portfolio you think you're looking to fill in? Or are you seeing -- it's hard to think you're seeing attractive valuations, but you never know. The figure that I ask, but maybe your thoughts on M&A?

Neil G. Mitchill - Raytheon Technologies Corporation - CFO

Yes. Valuations, it is hard to see attractive valuations, but good properties are also expensive. So we will see. But like we've been talking about, we believe we've got a great set of businesses, franchises, technologies here at RTX. But we do continue to look to fill in technology gaps that we might see. And so there'll be some bolt-on acquisitions.

Recently, you saw FlightAware. You also saw SEAKR Engineering, both companies that we think fill a void that we have. FlightAware is going to help us with our connected ecosystem. In fact, I was at Collins the other day and saw some demonstrations of our ability to really harness the data coming off of various systems in the aircraft and put that together for customers to make really well-informed decisions.

So I think those are the kinds of things you'll see, Peter. We'll also be looking at selective dispositions. We saw that we entered an agreement to divest the RIS government services business. So those are the kinds of things. Of course, you never know what happens with M&A, but we're certainly looking at those small bolt-on type acquisitions in the coming years.

Peter J. Arment - Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst

That's terrific. I know we're up in the final. Maybe just 1 more random question. I know it's a focus area for a lot of good companies just ESG. Just any kind of last comment you want to make on kind of the ESG that because I think it's important, just has a lot of focus on it.

Neil G. Mitchill - Raytheon Technologies Corporation - CFO

Yes, that's a great question, Peter. So ESG for our company is incredibly important. We have spent a lot of time as a leadership team talking about ESG and making sure that we're aligned with the right priorities and for all of our stakeholders, both on the employee side, governance. Obviously, with respect to social awareness, we've published a lot of reports in that regard. We'll do more forthcoming. But clearly, our priority cuts across the entire company. And it gets to really about our priorities of what we think are most important for our employees, our shareholders and our customers.

So you'll see more from us on that front. But great progress on environmental metrics. We're focused on diversity and inclusion and the right types of governance metrics as well as doing things that are socially responsible.

Peter J. Arment - Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst

Well, that's a terrific rundown. I appreciate that. I appreciate your joining us today in the conference and we certainly look forward to seeing you in person and the rest of your team, and I know we're all making progress on that. But thanks again for joining us for the conference and supporting the event. Thanks again, Neil.

Neil G. Mitchill - Raytheon Technologies Corporation - CFO

Thank you, Peter.

Peter J. Arment - Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst

Thank you.

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