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Procore Technologies, Inc. (PCOR)

Q2 2022 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon, everyone. Thanks for attending today's Procore Technologies, Inc. Fiscal Year 2022 Q2 Earnings Call. My name is Don Tame, I'm your moderator for today's call. All lines will be muted during the presentation portion of the call with opportunity for questions-and-answers at the end. [Operator Instructions]

I would now like to pass the conference over to our host, Mr. Matthew Puljiz, VP, FP&A and Investor Relations. Mr. Puljiz?

Matthew Puljiz

Vice President-FP&A and Investor Relations, Procore Technologies, Inc.

Thanks. Good afternoon, and welcome to Procore's 2022 second quarter earnings call. I'm Matthew Puljiz, VP of FP&A and Investor Relations. With me today are Tooe Courtemanche, Founder, President and CEO; and Paul Lyandres, CFO. A complete disclosure of our results can be found in our press release issued today, which is available on the Investor Relations section of our website. Today's call is being recorded and a replay will be available following the conclusion of the call.

Comments made on this call may include forward-looking statements regarding our financial results, products, customer demand, operations, the impact of COVID-19 on our business and other matters. These statements are subject to risks, uncertainties and assumptions and are based on management's current expectations as of today, August 3, 2022. Procore undertakes no obligation to update any forward-looking statements to reflect new information or unanticipated events, except as required by law.

If this call is replayed or viewed after today, the information presented during the call may not contain current or accurate information. Therefore, these statements should not be relied upon as representing our views as of any subsequent date.

We'll also refer to certain non-GAAP financial measures to provide additional information to investors. A reconciliation of non-GAAP to GAAP measures is provided in our press release. Additionally, we may refer to certain results as organic, which we generally define as business performance or results that exclude the acquisition of Levelset. However, with respect to our customer count metrics, we define organic to mean customers under Procore contracts.

And with that, let me turn the call to Tooey.

Craig F. Courtemanche

Founder, President, Chief Executive Officer & Chairperson, Procore Technologies, Inc.

Thanks, Matt. Welcome, everyone, and thank you for joining us today. I am pleased to share that we delivered another solid quarter of growth in Q2. We made strides towards our vision of improving the lives of everyone in construction and continue to see great returns from our platform investments.

In Q2, we released over 60 product enhancements to help our customers save time and increase productivity. I'd like to start off by sharing a couple of exciting updates to Preconstruction and Financials, two strategic areas that are critical to our customers and are vital components of an end-to-end platform for construction.

We continue to build on our estimating functionality within Preconstruction with the launch of Automated Area Takeoff. This leverages machine learning technology to significantly reduce the amount of time required to perform area takeoffs, which has historically been a very manual process of counting items on blueprints.

We also made exciting progress in bid management with the introduction of Bid Management 2.0, which gives bid managers higher quality data and expanded functionality including the ability to more effectively compare bids.

We also continued to innovate in our financial management offer. This quarter, we added new data sets to our enhanced reporting tool for our Financials to help our customers better analyze project information and make better financial decisions about their businesses and field operations. These are just a few examples of the product enhancements we made in the quarter to continue delivering added value to our customers.

More recently, we announced the launch of Procore Workforce Management, a powerful labor management solution that brings together Procore's field productivity product with LaborChart's workforce planning product from last year's acquisition. With the persistent labor shortage that our industry faces, I am excited to be able to offer an end-to-end solution that will help our customers better manage their most important resource: their people. I am so proud of the work the team is doing to enhance our platform to put the needs of our customers first.

This hard work continues to be recognized. Recently, we earned a 2022 Top Rated Construction Product Award from TrustRadius. We maintained top honors across nine categories in G2's 2022 Summer Report, and we were named as one of the top 100 software companies in 2022 by the Software Report. This is a testament to our continued partnership with the construction industry.

I am very proud of what the Procore team and the industry have continued to accomplish in a dynamic environment. And speaking of, I'm sure you're all interested in hearing our perspective on the demand environment. Currently, we view our continued strength as being primarily driven by internal factors rather than external. We continue to see positive indicators in our business, and our pipeline generation remains healthy.

Most of the external construction indices that we track are trending positively. So, objectively speaking, the near-term indications are stable to positive. With that said, we acknowledge the external environment remains highly dynamic, and we are very aware of what we're seeing in the news and hearing from our software peers.

While our customers continue to have healthy project backlogs and manage diverse portfolios of work, they are constantly evaluating the mix of their portfolios. In my outreach to the industry, I'm finding general optimism with some folks beginning to integrate more recession-proof work into their portfolios. Overall, demand still exceeds supply with labor continuing to be the primary limiting factor in meeting this demand. Related to this point, analyzing what has happened in construction over the past decades is a helpful guide on potential outcomes.

In the last 30 years, there have been a few recessions from the dot-com bubble to the financial crisis to the COVID pandemic. Yet total construction spend actually grew through many of these recessions, the one exception being the global financial crisis of 2008. If you dig a layer deeper, you'll find that during the financial crisis, residential construction took the largest hit by far, while commercial construction saw a modest decline and infrastructure remained resilient and even grew. Fast forward to COVID in 2020, commercial and infrastructure spend remained fairly flat, while residential construction spiked to be with the overall spend.

Procore has a diversified customer base, and that we don't have concentrated exposure to any one particular sector of construction. And history has shown that not all pockets of construction respond the same to downturns,

which is why when investors asked me, how will we perform during the potential recession? My answer is nuanced. It all really depends upon the severity and length of a recession and how different sectors within the industry may respond. Customers often remind me that their larger projects can take 24 to 36 months or even longer, so many of their projects span the duration of previous recession.

All of this is to say that no recession looks the same. And while the construction industry isn't immune to downturns, as a whole, it has historically remained resilient. We will continue to focus on what we can control, which is executing on our mission of connecting everyone in construction on a global platform. I maintain conviction that we are solving the industry's most pressing challenges. And if anything, we're hearing the industry say more and more that they're seeking efficiencies in the construction process, efficiencies that Procore's platform provides.

Over the past few quarters, you've heard us talk about the strategic value that Levelset brings to our long-term fintech initiatives. These initiatives tie back to our overarching goal of helping our customers manage risk and accelerate growth to ultimately run better businesses. You've also heard us talk about our focus on creating a robust set of solutions for specialty contractors, which you may know as subcontractors or subs.

One of the fintech initiatives we have been exploring is a material financing program specifically aimed at addressing a core challenge that many subs face. When subs start a new job, one of the biggest upfront expenses is the procurement of materials. Subs typically receive 30-day payment terms from their material suppliers, but they may not get paid by the general contractor for approximately 120 days after procuring the materials. This mismatch in payment timing creates working capital constraints for subs.

Subs represent the majority of firms on a given project, and yet, they often have limited credit history and difficulty accessing capital from traditional sources. Due to the complex nature of construction, traditional sources of capital typically have limited insights into the industry-specific information that they need to evaluate the full financial health of subs on a given project, including the upstream stakeholders that they're working with.

This lack of capital often forces subs to juggle funds between projects and hold off on bidding on new projects that they could otherwise be qualified. Ultimately, this adds uncertainty to sub's cash flow, constricting their ability to grow, which, in turn, constrains the industry's overall growth and efficiency. Both Procore and Levelset have shared a long-term interest in solving these working capital constraints for the industry. This is an area we've discussed with you in the past. And I'd like to dig deeper on this today as we've made some early strides and started to deploy a small amount of capital.

At the highest level, our material financing program facilitates the purchase of construction materials on behalf of subs. Procore helps to alleviate working capital constraints by purchasing materials directly from suppliers and then selling them to subs on deferred payment terms that are better aligned with their terms. We charge an origination fee at the beginning of the arrangement, as well as a weekly finance charge with the expectation that the subs will typically pay us back in approximately a 120 days.

So let me walk you through an example. When a sub starts a new job and needs to procure material, rather than paying the supplier upfront, as sub would come to us with the project details and its list of materials needed, and we would conduct a short underwriting process.

During that underwriting process, we leverage our available proprietary data, including creditworthiness of not just the sub, but also other upstream stakeholders to determine whether to provide financing. Once an applicant is approved, Procore purchases the materials directly from the supplier, who then ships the materials to the job site.

And because we purchase the materials directly and sell them to the subs for use on the job, we were able to obtain lien rights, which means our financing can be secured against the property itself, and where need be enforced to ensure repayments.

We believe we are uniquely positioned to solve this challenge for several key reasons. First, as a connected platform for the industry, we have a huge audience of cash strapped subs, both collaborators and customers. Second, thanks to our single global cloud-based platform, we have a unique and massive amount of data, inclusive of Levelset's datasets, which provides specific insights in the performance of payment history. And third, our deep domain knowledge of lien rights.

By structuring this program so that we secure financing with lien rights, we have a powerful tool to collect outstanding balances, not just from the subs, but in circumstances where they are unable to pay from the upstream stakeholders.

Moreover, we can leverage Levelset's core lien management offering to manage, track and enforce our lien rights at various states and jurisdictions. Also, it's important to note that this program does not require us to warehouse, ship or otherwise take possession or control of materials, and we are not responsible for the subs performance on the job. I want to emphasize that we are in the very early stages of this program and our focus is to continue learning and optimizing. And while it's still early, I am excited for the potential impact and the value this program can bring to the industry.

Ultimately, we believe that we're successful with this program. It should provide meaningful expansion to our TAM that is highly complementary to our existing SaaS platform, strengthening the Procore flywheel.

Speaking of the Procore flywheel, we continue to grow our customer base with a number of notable customer wins in the quarter. I'd like to share a few of these things starting with a notable owner. Tampa General Hospital is one of the largest hospitals in America with a main campus, outpatient facilities and urgent care centers. They have previously been using the solution that was time-consuming and labor-intensive. And they desired a platform that was easy to use and met the reporting and integration needs. They selected Procore after the contractors who they frequently work with urged them to explore us. It was also our existing customer relationships with other hospitals, serving as references for our partnership abilities that gave them additional conviction to become a Procore customer, a testament to the flywheel effect of our platform.

In addition to owners, we continue to build relationships with general contractors. [ph] J.P. Collin (00:13:50) is a fifth-generation family-owned general contractor managing projects across multiple construction sectors in the Midwest and nationally. Their project teams have been struggling with disconnected systems, and they needed an integrated platform that could increase their efficiency, improve financial controls, and enhance user experience for employees in the field.

After evaluating several options, they ultimately chose Procore given their confidence in our platform to support these needs. Their decision to become a customer was bolstered by the positive feedback they received from their employees who had previous experience using the platform.

We also signed Mattamy Homes, the largest privately owned homebuilder in North America with over 40 years of history across the US and Canada. They have plans to grow their residential property offering with speed and scale. Mattamy have been using a number of point solutions and we're looking to consolidate their business onto a single platform that could scale along with their growth ambitions. After an extensive evaluation, they selected Procore.

Procore is going to be initially used on a large high rise, mixed-use development project but subsequently on future residential projects as they're rolled out. Procore's platform will allow them to have all their project information accessible on a single platform, gain real-time insights into projects, and seamlessly share information across stakeholders as their business grows. We look forward to supporting their continued growth.

In addition to expanding our customer base to expanding our customer base of owners of GCs, we continue to bring specialty contractors under the platform. Houle Electric is one of British Columbia's largest electrical contractors. They desired an all-in-one platform that could bring together critical business processes like timesheets, productivity and inspections, and be standardized across the field and office.

After a competitive evaluation process, Houle ultimately chose Procore as their platform of choice with the ROI we could provide in the form of increased efficiency, productivity and accessibility of information. They particularly valued our strength in open APIs, our local presence in Canada, and our focus on specialty contractors, including our workforce management capabilities.

Speaking of building relationships with customers, a huge part of how we connect with the industry is through our annual conference, Groundbreak. I am thrilled to share that after two years of going virtual, Groundbreak will be taking place in-person this year.

With that, I'd like to invite you all to join us at Groundbreak 2022 in New Orleans from November 7 to November 9. It's going to be an incredible three days of exchanging ideas, hearing about new products and innovations, and connecting with our customers, partners and the broader community. We hope to see you all there.

Now, I'm going to hand it over to Paul.

Paul Lyandres

Chief Financial Officer, Procore Technologies, Inc.

Thanks, Tooey, and thanks, everyone, for joining us. As Tooey mentioned, we delivered another solid quarter. Today, I'll quickly recap our financial results, provide some color on the quarter and conclude with our outlook. We had strong top line performance with revenue in the quarter of \$172 million, up 40% year-over-year and up 34% organically when excluding Levelset \$7 million contribution. Our backlog metrics, specifically short-term remaining performance obligation, and short-term deferred revenue continued their strong trajectory in the quarter.

On an organic basis, we ended the quarter with 13,403 customers, representing 20% growth year-over-year. Our non-GAAP operating loss was \$25 million, representing a consolidated operating margin of negative 14.7%.

Taking a step back, there are a few things I want to call out with respect to Q2. As Tooey mentioned, we currently view our performance as being driven primarily by internal factors rather than external. I first want to touch on two areas where we saw unexpected impacts related to internal factors. First, while we delivered Q2 operating margin in line with our guidance, there were a couple of expense areas that came in both higher than anticipated and towards the very end of the quarter. One, we saw an increase in travel and entertainment spend, reflective of more people returning to travel and in-person customer engagement.

While it's a great sign that our pipeline is healthy and customers are eager to meet, it is also a reminder of the importance of re-engaging the protocols of managing T&E that were utilized pre-COVID. Therefore, we do not anticipate the T&E trajectory we saw in Q2 to persist for the remainder of the year. Two, we also saw incremental expenses related to our cloud hosting provider, driven by higher consumption and usage of the platform, which

led to a slightly lower gross margin reflected within our Q2 results. The combined T&E and hosting expenses contributed an impact of approximately 160 basis points of headwind to Q2 operating margin.

Second, although we saw pockets of strength in certain regions, like Canada, overall, our international business experienced some growing pains in Q2. Over the last 18 months, we have expanded into multiple countries and have been judicious with building the right teams. As a result, in some cases, it's taking longer than expected to onboard the appropriate talent and get them productive. We are cognizant that there is more work to be done as we focus on our international execution.

We're also mindful that there is a higher potential for recession in Europe, which could further impact our business there. Therefore, we have tried to factor all these dynamics into our outlook and guidance. Ultimately, we continue to have conviction in the product market fit and need for our offering internationally, and we remain excited about the massive opportunity of our international business long term.

Despite these items, we delivered solid results in Q2, and there were several highlights that I would call out. First, overall pipeline generation remained healthy in the quarter, continuing the momentum we've seen this year. This is another data point reflecting that even in times of uncertainty, demand remains strong for Procore's platform.

Second, specialty contractors in particular saw meaningful year-over-year growth. This is a key stakeholder for which we have been doubling down on creating robust solutions. So seeing this performance in Q2 is promising.

And third, we saw strong momentum in expansion across all facets of the business. This strength and expansion drove continued improvement in net retention. We intend to provide additional disclosure on the dynamics of this metric later this year.

Before I turn to our outlook and comment on free cash flow dynamics, I want to spend a few minutes sharing a bit more on our material financing program. As Tooey stated, we have a unique opportunity to solve a huge working capital problem in construction. I want to emphasize that while we are making early strides, we are still in the learning phase of this opportunity. Our current priority is building our game team, which means thoughtfully distributing a select amount of capital so we can identify signals in our data and better predict potential repayment risk.

As we continue to learn and develop the program, our intent is not to scale it using our own balance sheet. If the program proves to be successful, we would expect to partner with a capital provider in the future who can help us scale this initiative.

As of the end of Q2, we had \$12 million in originations outstanding, of which, we expect the vast majority to be repaid generally in approximately 120 days. During that period, we would continue to collect a weekly finance charge associated with the amounts outstanding in addition to the origination fees we received. To date, defaults have been limited and amounted to fewer losses than the revenue collected from the program. That said, the program is not expected to generate a material amount of revenue this year.

As we continue to learn and build our portfolio of data, we are comfortable with having up to approximately 10% of our cash position on the balance sheet tied to this program prior to onboarding a capital partner. We believe this is an appropriate amount of capital to collect sufficient data on this program, evaluate performance, and if and when appropriate, secure the best capital partner.

In the broader context of our fintech ambitions, material financing is just one of several early bets we are making to address the industry's biggest priorities of managing risk and accelerating growth. Depending on what we learn and what our [ph] gain (00:22:43) take shows, this program could evolve and take different forms over time. Ultimately, we remain focused on determining the highest value opportunities to pursue.

With that, let me move on to our outlook. As Tooley noted, the broader environment remains highly dynamic. Regarding our revenue guidance, we have tried to take into account this uncertainty and factor in the potential for incremental weakness in the market that we have still not seen in our business today. Should our demand environment remain stable, we see room for upside to our guidance. We took a similar approach during our Q1 earnings call to set guidance at a level we felt was appropriate based on these same external dynamics.

Now, here is our guidance for Q3 and full-year 2022. For the third quarter of 2022, we expect revenue between \$174 million and \$176 million, representing year-over-year growth between 32% and 33%. Q3 non-GAAP operating margin is expected to be between negative 13% and negative 14%. For the full fiscal year 2022, we expect revenue between \$690 million and \$694 million, including a contribution of \$29 million from Levelset, representing total year-over-year growth between 34% and 35%.

Given the small size of our material financing program, we are not expecting a material revenue contribution from that initiative this year. Non-GAAP operating margin for the year is expected to be between negative 13% and negative 14%, an improvement of 50 basis points from our previously issued guidance last quarter. This also represents 200 basis points of improvement compared to our original operating margin guidance issued in February.

And finally, although we do not guide free cash flow, we have provided directional color in the past on the trend line for free cash flow margin for the year. We would reiterate the commentary we shared back in May and note that due to the timing of collection and various outflows, the distribution of free cash flow by quarter is not linear. Specifically, free cash flow in Q2 is expected to be the trough and not indicative of free cash flow for the year.

For the full year, we would note that the analyst consensus of approximately negative 6% free cash flow margin remains in line with our expectations. As it relates to material financing, we would note that the activities associated with the program are included in investing activities on the cash flow statement and therefore excluded from the definition of free cash flow.

Before I wrap up, building on Tooley's invitation at Groundbreak, I'd also like to invite you all to join us at our inaugural Investor Day, taking place in conjunction with Groundbreak on November 8 in New Orleans. We will be sharing more details on how to attend over the coming weeks. We hope you can join us. I'd like to close out by again thanking our customers, partners, employees, shareholders and the industry, as well as the communities we serve for giving us this opportunity.

With that, let's turn it over to the operator to begin the Q&A session.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Our first question comes in from the line of Dylan Becker with William Blair. Mr. Becker, your line is now open.

Dylan Becker

Analyst, William Blair & Co. LLC

Q

Hey, guys. Thanks for taking the questions and congrats on the quarter here. Maybe if we start on the materials financing piece, something we've kind of talk a lot about. But can you talk about maybe how the platform data and the visibility you have seen? What these guys are bidding on? What their backlog looks like? How that enables you to make better underwriting decisions, right, maybe better offer, better financing terms for these stakeholders? And why this data is something that that can't maybe necessarily easily be replicated and that's something that has taken time for you guys to build out as well?

Craig F. Courtemanche

Founder, President, Chief Executive Officer & Chairperson, Procore Technologies, Inc.

A

Yeah, Dylan. Great questions. Area that we're all very excited about. So we do think that we have this unique vantage point that others don't. We have all of the data that you mentioned. It's around data like performance and payment history, the creditworthiness of subs and stakeholders. And it gives us this visibility kind of across the spectrum. We also get to see the entire job ecosystem that they're involved with, which is something that most people would not have access to. So it's this – it's a broad amount of data that we have access to that really is something that can only come from a solution that is a single connected platform.

Paul Lyandres

Chief Financial Officer, Procore Technologies, Inc.

A

Yeah. And maybe the only thing I'd add is, it's an interesting callout on the bidding side of the house because what the bidding side of house not only does is it gives the vantage point [indiscernible] (00:27:54), but it also really reflects that other point we had talked about of having this massive audience of cash-strapped subs. It's at the time [ph] off bid (00:28:02) that you're able to actually see how we are, what is the size of the amount of money they need for material financing and get to them at the right moment of need because that is essentially the time by which they will be awarded a job and be looking to go out and procure this financing for these materials. And so, there's a lot of reasons why both the huge audience, the data set and, frankly, our knowledge on lien rights really makes us a unique – in a unique position to go after this opportunity.

Dylan Becker

Analyst, William Blair & Co. LLC

Q

Yeah. Super exciting. I appreciate the color. I look forward to hearing more on that one. And maybe if we talk about. Tooey, that you called out some of the international component. But as you think about the business model in its own, right, can you think about as maybe some of your customers are dealing with their own cost pressures, obviously, some of the macro landscape as well with the value in that collaborator model and maybe the ease of adoption they're getting that upfront that burden out of the way at the time to value that increases not only that top of funnel but maybe accelerate those customers realizing that aha moment and easing that onboarding process from a new customer perspective as well? Thanks.

Paul Lyandres

Chief Financial Officer, Procore Technologies, Inc.

A

Yeah. I mean, I think you said it better than we may be able to in the sense that the model that has been so successful for us in the US, where we are in limited use our model and that our average new customer [indiscernible] (00:29:25) many, many new collaborators who are customers that could be potential customers, it's something that is equally applicable as we look about our – look out to our international expansion. And one of the reasons why when we highlighted our excitement around the international opportunity and the investments we would be making over the years in the past is why we think we're in such a unique position to be successful internationally and why it's something that we remain really excited about from an opportunity perspective.

Craig F. Courtemanche

Founder, President, Chief Executive Officer & Chairperson, Procore Technologies, Inc.

A

Yeah, Dylan, quickly, I spoke to one of our largest international customers today and they reminded me that when we enter a new market, they are as incentivized as are to build our brand and to spread the word about Procore and to get everybody on the platform because they're making an investment in our platform and they want to see that we succeed. So, that is one difference that we're seeing just because we're a new brand in a new market. That's really exciting.

Dylan Becker

Analyst, William Blair & Co. LLC

Q

Great. Appreciate the color, guys, and [ph] congrats again (00:30:20) on the quarter.

Craig F. Courtemanche

Founder, President, Chief Executive Officer & Chairperson, Procore Technologies, Inc.

A

Thanks, Dylan.

Operator: Thank you for your question. Our next question comes from the line of one Saket Kalia with Barclays. Your line is now open.

Saket Kalia

Analyst, Barclays Capital, Inc.

Q

Okay. Great. Hey, guys. Thanks for taking my questions here. Tooe, maybe for you, and apologies if this was addressed earlier, I joined the call late. But I was wondering if you could talk a little bit about the subcontractor segment. It sounded like that grew faster than the overall business. So maybe if you could just touch on what product areas are subcontractors using the most from Procore? And remind us how they're paying for it?

Craig F. Courtemanche

Founder, President, Chief Executive Officer & Chairperson, Procore Technologies, Inc.

A

Yeah. So, first, the subcontractors are a vital component and a vital stakeholder for us. They represent the vast majority of folks on any particular job. So for us, it's always been a market that we wanted to go out and serve. When we've been investing in this segment for the last couple of years, that's where the LaborChart acquisition came in, that's where our workforce management products that we're doing, as well as a whole host of other things that we're doing to capture that. They pay us the same way all of our other customers pay us. It's a – there's no – we don't have a different program for them. But ultimately, we need to get all of the players on the project connected. And we couldn't be successful in our mission if we didn't bring them into the fold.

Paul Lyandres*Chief Financial Officer, Procore Technologies, Inc.*

A

Yeah. Maybe the only thing I'd add is, when we think about the product mix the subcontractors are adopting, I think that's one of the most exciting aspects about the platform that we are able to monetize our existing offerings across project management, quality and safety, financials, while also offering very differentiated value in places like workforce management. And this is where we believe these investments we've been making are critical and have started or continued really to pay off as we go after this massive opportunity with subcontractors.

Saket Kalia*Analyst, Barclays Capital, Inc.*

Q

Got it. Got it. That makes sense. Paul, maybe – maybe for you while I have you, I'd [ph] love (00:32:21) to talk a little bit about how you're approaching Europe, right? I think you said it, well, the highest probability of a macro hiccup here. I know it's not a big part of the business, but obviously, somewhere where Procore would like to grow, what are you seeing there, again, just kind of given the limited sample size and have you thought about that business this year as part of the guide?

Paul Lyandres*Chief Financial Officer, Procore Technologies, Inc.*

A

Yeah. I think that you called it out. Europe is not a large part of our business. Our biggest investment area in Europe has been in the UK, and even still, it's still a relatively small part of our business. When we talked earlier in the quarter or last quarter, I should say, about entering France and Germany, these are really multi-year investments meant to put ourselves in a position to have a really meaningful market share as we grow in those regions. And so, as we think about Europe, we still believe today our success, not just in Europe, but really the broader international market is going to be on our own execution and that there will certainly be headwinds associated with different components of the macro over time, but that it's still so early days and the markets are still massive that we're going to continue to invest there. We're just going to be really thoughtful and intentional around how we do that.

Craig F. Courtemanche*Founder, President, Chief Executive Officer & Chairperson, Procore Technologies, Inc.*

A

Saket, the dynamics in Europe are very similar to the US, where when they see these macro headwinds, the governments step in and they invest in infrastructure. And in fact, in a lot of cases, they're investing now in housing because interest rates are – inflation is so high that people can't afford rents. So those dynamics are very, very similar. So, we're obviously remaining very optimistic about what we can achieve there.

Saket Kalia*Analyst, Barclays Capital, Inc.*

Q

Very helpful, guys. Thank you.

Craig F. Courtemanche*Founder, President, Chief Executive Officer & Chairperson, Procore Technologies, Inc.*

A

Thank you, Saket.

Operator: Thank you for your question. Our next question [ph] is coming (00:34:07) from the line of one Brent Bracelin with Piper Sandler. Brent, your line is now open.

Brent A. Bracelin*Analyst, Piper Sandler & Co.*

Q

Thank you. Good afternoon. Tooley, I wanted to double click into the specialty contractor segment as well. If I look back over the last four, five years, I know the owner segment really kind of took off and became a meaningful driver of the business as they adopted the platform. It sounds like now specialty contractors are starting to kind of come alive. What's driving that? Is it new product that's resonating? Give us a little more color on kind of why are you seeing the momentum with that specialty contractors now?

Craig F. Courtemanche*Founder, President, Chief Executive Officer & Chairperson, Procore Technologies, Inc.*

A

Yes. So, Brent, great question. I would characterize it a little bit differently. I don't -- we've been serving the subcontractor community for a long time. And so, they've always had a place in our stakeholder customer base. But we have made a very intentional push to make sure that we're satisfying the need -- their needs over the last two years or so. And the good news is, is that as all the collaborators on our platform, remember, 60% of the folks using Procore not paying customers. Most of those are specialty contractors. As they see the value in Procore because they're in the general contractors or an owners account, they start asking themselves, how can I get the value? And now that we have specialized features and products that actually serve their needs directly, I think that that's just an accelerant on them coming on board.

But ultimately, we need everybody on the platform, and just I'm grateful that they're joining us. And material financing is another great example, which is -- we're here to help the specialty contractors with their business needs and being cash-strapped as they are because they're having upfront all the money for materials is just another way that we're leaning into the specialty contractor market.

Paul Lyandres*Chief Financial Officer, Procore Technologies, Inc.*

A

The only thing I'd build on top of that is also say like, hey, as we've decided to focus into the subcontractor market, we put the resources in go-to-market as well. And so we try to be really thoughtful about how we marry those investments on the R&D product side alongside the go-to-market so that we're able to really show that success that comes from those investments, and we're just continuing to see that pay off.

Brent A. Bracelin*Analyst, Piper Sandler & Co.*

Q

Great. It sounds like features, focus and putting some sales efforts behind it is certainly paying off here. And then, Paul, just as a quick follow-up for you, if I just look at the short-term RPO build here, still pretty strong, even with some of the flags around international. Is that just because international is only 15% of the business and the bulk of the business in the US here still strong? Just walk us through what drove the strength in short-term RPO build this quarter that looked really healthy?

Paul Lyandres*Chief Financial Officer, Procore Technologies, Inc.*

A

Yeah. I think that international is a smaller piece, and though, as we said, hit some growing pains, it still performed quite well. So I don't want to say that international hasn't continued -- contributed for underlying revenue [ph] in that roadmap (00:37:08). I would say we continued to see strengths from the various facets of the US business as well. That's the various stakeholders. We called out, in particular, we're seeing really good momentum and expansion. And so it is a permutation of all of those different things coming together that continue to show strong execution on the business side.

Brent A. Bracelin*Analyst, Piper Sandler & Co.*

Q

Great. Well, it sounds like the business is performing pretty well here. Thanks for the update.

Craig F. Courtemanche*Founder, President, Chief Executive Officer & Chairperson, Procore Technologies, Inc.*

A

Thanks, Brent.

Operator: Thank you for your question. Our next question comes from the line of DJ Hynes with Canaccord. Mr. Hynes, your line is now open.

David Hynes*Analyst, Canaccord Genuity LLC*

Q

Hey, thanks guys. Appreciate all the macro and demand commentary, Tooey on the call. Paul, one for you, if I understood your comments around the revenue model for materials financing, this should be a massively profitable effort at scale. Am I thinking about that right?

Paul Lyandres*Chief Financial Officer, Procore Technologies, Inc.*

A

We think it has a lot of potential and that it should drive great economics at scale. And the thing that we would continue to bring people back to that we're really early days. And so we're learning a lot. We still have a lot of data points that we're collecting. And as you've heard us say, this program continue to take many different forms or shapes. But I assure you, when we think through the investments we're making in the fintech world, we're very thoughtful to making sure we're going to put our money where we see the most opportunity and the best kind of economics for the business.

David Hynes*Analyst, Canaccord Genuity LLC*

Q

Yeah. It makes sense. And then Tooey, what was the appetite for M&A these days? I mean, are you seeing more point solution consolidation opportunities out there in this environment?

Craig F. Courtemanche*Founder, President, Chief Executive Officer & Chairperson, Procore Technologies, Inc.*

A

I would say, in general, the appetite is very low. We are definitely still digesting the last two that we had acquired. There are a lot of players in the space. And I think back, DJ, to the early days of our platform, where we had -- I think what we had 20 partners building on our platform; and today, we have over 400. So, the opportunities are somewhat endless. But for now, we are -- we think focus matters. And so, we're keeping an eye out. But really right now just staying focused.

Paul Lyandres*Chief Financial Officer, Procore Technologies, Inc.*

A

And the benefit of that platform and those partnerships, as Tooey, alluded to is that we're constantly having conversations with all the different folks out there, build relationships, getting to know their management teams, their R&D development teams, go-to-markets as we pursue partnerships and integrations together. And so, by no means are we refraining from making sure we're watching the market, understand what's out there, have the right

relationships. We just believe that it's really important we focus on being very successful with the integrations we've already brought on, and that's our immediate short-term focus.

Craig F. Courtemanche

Founder, President, Chief Executive Officer & Chairperson, Procore Technologies, Inc.

A

And actually, DJ, we just posted 10 of our top integration partners on campus to help them build their business and refine their tech stack and learn how to attract and retain talent. So, we invest heavily in these relationships.

David Hynes

Analyst, Canaccord Genuity LLC

Q

Yeah, yeah. Great to hear and congrats.

Craig F. Courtemanche

Founder, President, Chief Executive Officer & Chairperson, Procore Technologies, Inc.

A

Thank you.

Operator: Thank you for your question. Our next question comes from the line of Adam Borg with Stifel. Adam, your line is now open.

Adam Charles Borg

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Hey, guys. And thanks for taking the questions. Maybe just to beat a dead horse on the macro side. So it's great to see the strength on the specialty contractor front, but maybe talk a little bit more about customer trends either by size, right? We've talked in the past about SMBs versus the larger GCs and owners. And then maybe just on the international front, just to be clear, is what you're seeing today simply that is taking longer [ph] to higher (00:40:52) than you expected or some of the macro headwinds that are impacting Europe are starting to impact your business? I just want to be clear on which – is it all the above? Or which one is it? Thanks so much.

Paul Lyandres

Chief Financial Officer, Procore Technologies, Inc.

A

Yeah. Maybe let me try to break those down into two different questions. So when we look at the US side and you talk about the mix of customer size of stakeholder, I would tell you that there isn't a lot to say or new things to add here versus what we had commented on last quarter. From an absolute customer count adds, it's always important to remember that the largest driver of our customer count in any quarter is going to be the SMB audience. They are still the ones as we continue to face supply chain dynamics, uncertainty that are the ones who are most impacted just in their ability to focus on new things while they manage their existing businesses. But beyond that, I wouldn't tell you there's anything unique to call out between stakeholders to owners, GC subs, other than we continue to see the investment payoff and subs, in particular, is showing really great promise.

If I go to the other question focused on international, I think, right now, we're deliberate in saying that it's not the macro environment that we want to call out. We're really saying that, hey, the business is still really early, right? International represents 15% of our business and we will see lumpiness from quarter-over-quarter as we invest in these regions because they're smaller and bringing on the right talent is so important. And so we're being really judicious to double down on that. We want to make sure we have the best talent and that we spend the time to invest in getting them productive and making sure that they're the best folks on the team we can have. And that's why we've seen some growing things there but we remain really opportunistic -- really optimistic and believe that

the original thesis for which we entered these markets and why we were so bullish on international has not changed.

Craig F. Courtemanche

Founder, President, Chief Executive Officer & Chairperson, Procore Technologies, Inc.

A

And I want to point out, Adam, that one thing that I'm really proud of. In 2021, our international team was one of the highest performing teams that we had at Procore. So I am confident we've got the right people and that the future is bright. And these are just learnings that come as you enter new markets.

Adam Charles Borg

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Got it. And maybe just a very quick follow-up, just on inflation. Obviously, its another macro data point we keep on talking about. Just curious, what kind of impact that's having if anything on your annualized construction volumes? Thanks again.

Craig F. Courtemanche

Founder, President, Chief Executive Officer & Chairperson, Procore Technologies, Inc.

A

Yeah. Well, let me tell you a little bit about what I'm hearing from our customers, that inflation is not the number one issue. By the way, the sentiment -- and people don't really ask this question, I'll just answer it. This customer sentiment from all the calls that I'm doing is very similar to last quarter, where mostly everyone I'm talking to has -- remains largely optimistic. They have not seen, for the most part, the dynamic macro environment impacting their business.

So when they tell me about how they look at their business, they talk about a diversified portfolio and so that diversified portfolio will be anything from like public sector to private sector, and they're very focused on doing that. So they're seeing strength -- areas of strength in like healthcare, education, energy and manufacturing, but they're not bringing up inflation as being the number one issue. As a matter of fact, one of our customers told us they were actually purchasing materials at the beginning of the job starting to offsite, so they can lock in the material costs. So inflation is not a matter. And what's really cool about that is that demonstrates to all of us how resourceful the industry is that we serve and how clever they can be to solve these challenges.

Paul Lyandres

Chief Financial Officer, Procore Technologies, Inc.

A

Yeah, I would just remind everyone that as we look back over the last two plus years that this industry has been going through nothing but constant change and turbulence from supply chain dynamics to inflation that's been around for some time, particularly when we talk about materials and these different components that go in. This is an incredibly resilient industry and they continue to prove that and that's why they are always reminding us labor is their biggest constraint and they're always focused on getting more effective and efficient.

Adam Charles Borg

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Excellent. Thanks so much.

Craig F. Courtemanche

Founder, President, Chief Executive Officer & Chairperson, Procore Technologies, Inc.

A

Thanks, Adam.

Operator: Thank you for your question. Our next question comes from the line of Brent Thill from Jefferies. Brent, your line is now open.

Brent Thill*Analyst, Jefferies LLC*

Q

Paul, when you think about the bottom line, I know it was a little bit worse than the Street side in your guidance, assuming still some pretty big losses here, I guess when you think about the pathway to breakeven in profitability, can you talk to -- has your path changed at all, or are you still holding path or court with the current plan? Thanks.

Paul Lyandres*Chief Financial Officer, Procore Technologies, Inc.*

A

Yeah. Look, I would tell you that we kind of outlined in the call a couple of things that came in unexpected from an operating margin perspective. And we feel really good we have those in mind, and it will not persist. That's why we felt very confident to improve our annual guide by 50 basis points. I think we will continue to be very judicious and vigilant there, but it's not something that we believe changed the way we think about that profitability.

As we've talked about in the past, when you look at our last three years, it can be a bit deceiving in the sense that COVID really threw some abnormalities into our three-year P&L. We went from a world in 2019 where we were at negative 21% operating margin. You fast forward to this year and really look at it from an organic perspective, taking out the headwinds we've talked about from Levelset, that looks closer to about negative 10%, and 2023 will be the period of time where we return back to a normal progression of operating improvements and efficiencies.

And so while the world is highly dynamic, we remain confident in our focus on both getting to breakeven from a free cash flow perspective as well as continuing to show efficiencies in the operating margin line item, and we're going to continue to do that.

Brent Thill*Analyst, Jefferies LLC*

Q

Thank you.

Craig F. Courtemanche*Founder, President, Chief Executive Officer & Chairperson, Procore Technologies, Inc.*

A

Sure.

Operator: Thank you for your question. Our next question comes from the line of Matthew Broome with Mizuho Securities. Matthew, your line is now open.

Matthew Broome*Analyst, Mizuho Securities USA LLC*

Q

Thanks very much. Hi, Tooeey and Matt and Paul. It sounds like you're making progress in terms of leveraging your data to address the financing opportunity. I'm really just curious, to what extent you're taking a similar approach to addressing the insurance opportunity, especially I know a couple of months ago, you issued a press release on that topic. So, I'm just curious with how much progress you made in that regard?

Craig F. Courtemanche*Founder, President, Chief Executive Officer & Chairperson, Procore Technologies, Inc.*

A

Matthew, I'm glad you asked that question. Data is a massive asset that Procore has, and with Joy Durling onboard, our new Chief Data Officer, putting a hyper focus on how we can leverage all of this data that we have across the platform and the levels of data to put together risk profiles is really exciting and we can use that for [ph] Math 5 (00:47:52). We can use that for insurance. And I know Paul is really passionate about this, so I'll let you kick it over.

Paul Lyandres

Chief Financial Officer, Procore Technologies, Inc.

A

[indiscernible] (00:47:58). Yeah. Look, I think it's a good callout. And if you've noted, as we talked in our transcript, we're making several bets in the world of fintech. As we think about the focuses of those bets, it really is around helping companies manage risk and grow their businesses. So [ph] Math 5 (00:48:16) really is a focus on how do you help grow these businesses because if these people do not have access to capital, they just don't bet on jobs, and it constrains our whole industry.

From the flip side, when we think about managing risk, that is where we've talked about some of the biggest costs that come to construction are in the world of insurance. And we believe we have really interesting opportunities to think about how we can leverage our data, leverage our customer base to help make meaningful improvements to the overall industry when it comes to that [indiscernible] (00:48:46) statement.

That said, I will always reiterate, these are very early days. These are early bets. They're not in any of our models, and we would encourage you all to continue to keep them out of yours as we are in the learning phase, and we'll continue to keep folks up-to-date as we learn more.

Craig F. Courtemanche

Founder, President, Chief Executive Officer & Chairperson, Procore Technologies, Inc.

A

And, Matthew, there is another aspect which we talked about in material finance, which is it's not just about the data, but its capturing people at the time of need. When a subcontractor gets awarded the job, they need to purchase specific insurance at that time. So there's two aspects to the advantages that we have, both the data and the time of need.

Matthew Broome

Analyst, Mizuho Securities USA LLC

Q

All right. Thanks for the detail there. And just, of course, good to see the top line momentum continue. But I guess your guidance does reflect quite a bit of deceleration in the second half of the year. Is that primarily due to sort of tougher comps or maybe the macro? And maybe just what are the puts and the takes that we should think about as we're modeling that? Thanks.

Paul Lyandres

Chief Financial Officer, Procore Technologies, Inc.

A

Yeah. I think, as we commented earlier in the script, what's important to take here is we are mindful that we are in a highly dynamic macro environment, that there's a lot going on that, as we said, we don't see in our business today.

That said, when we think about guidance in this dynamic environment, we want to be really mindful that we bake in what could be weakness that comes that we don't see today. And so if the demand environment remains stable, we think there's upside to that guidance. Otherwise, I don't think there's any in particular areas I would call out beyond that.

Matthew Broome*Analyst, Mizuho Securities USA LLC*

Okay. Thanks. Thanks very much.

Q

Craig F. Courtemanche*Founder, President, Chief Executive Officer & Chairperson, Procore Technologies, Inc.*

Thanks, Matthew.

A

Operator: Thank you for your question. Our next question comes from the line of Jason Celino with KeyBanc. Jason, your line is now open.

Jason Celino*Analyst, KeyBanc Capital Markets, Inc.*

Perfect. Thanks, guys. Thanks for [ph] putting (00:50:38) me in. Tooe, I think in your prepared remarks you mentioned that some of your customers are [ph] running (00:50:43) recession-proof work. I guess curious on what that means?

Q

Craig F. Courtemanche*Founder, President, Chief Executive Officer & Chairperson, Procore Technologies, Inc.*

Yeah. No, I – I'm glad you asked that [ph] because (00:50:53) clarity is important here. So, our customers, as I mentioned earlier, are always seeking to diversify their portfolio. So, it's easy to think that a contractor does one type of work, but most of them do not. And so having that diversified portfolio means that they're going to look at different types of work, and one of them would be more recession-proof.

A

So I'm hearing there's a lot of government finance projects that are coming online, infrastructure bills, the CHIPS Act, which was just passed for, I think, \$52 billion. And so, they're seeing that there's – those kind of infrastructure bills are somewhat recession-proof. In fact, they're – the government spends money during the recession in order to stimulate the economy.

So also, they're looking at projects that are either cash on hand or they're bond measures that were passed a long time ago that are coming online. So, there's just a lot of opportunities outside of the standard like bricks-and-mortar home construction that you might think of, where folks can focus their energy to diversify that portfolio.

Paul Lyandres*Chief Financial Officer, Procore Technologies, Inc.*

And it's worth calling out, I remember that even [indiscernible] (00:51:55), society has to keep running. So, there's always going to be healthcare, power manufacturing. These things have to persist because these are revenue-generating assets for these companies that they have to continue to focus on their long run projects.

A

Jason Celino*Analyst, KeyBanc Capital Markets, Inc.*

Perfect. Now, that's a fair point, Paul. And then when I think about the competitive landscape at the subcontractor level, are there, I guess – is it a different set of competitors or is it the same typical ones? Curious on what that looks like?

Q

Craig F. Courtemanche*Founder, President, Chief Executive Officer & Chairperson, Procore Technologies, Inc.*

A

It's very similar to our other prospects that we talk to. And most of them are coming from analog solutions, sometimes to point solutions. So, it's really not all that different. So, this isn't really as much of a competitive sale as it's helping people through the digital transformation from analog to digital. And there are so many out there that are on that journey. And I think we're well-positioned to help them.

Jason Celino*Analyst, KeyBanc Capital Markets, Inc.*

Q

Awesome. Thanks.

Craig F. Courtemanche*Founder, President, Chief Executive Officer & Chairperson, Procore Technologies, Inc.*

A

Thanks, Jason.

Operator: Thank you, Jason. Our next question comes from the line of one Ken Wong with Oppenheimer. Ken, your line is now open.

Ken Wong*Analyst, Oppenheimer & Co., Inc.*

Q

Great. Thanks for taking my question. [indiscernible] (00:53:14) everyone. I wanted to kind of dive in on the material financing side, but perhaps take it from a different angle. I recognize there's some transactional component to it come over time. How does that product potentially drive incremental attach of other software products? Is there a possibility that you get more data therefore it better qualifies some of the sub and that may force some of these customers to potentially pursue a broader suite of solution?

Paul Lyandres*Chief Financial Officer, Procore Technologies, Inc.*

A

Yeah. I think that we think these are highly synergistic. And when we take folks back to the overall mission of improving the lives of everyone in construction, you have to look at the needs of these stakeholders, the subcontractor, in particular, on the whole. They absolutely need software to make them better, more efficient. But they have a risk. They have working capital problems. As we introduce them to solutions that they love, we find that they increasingly look to what else we have to offer them and how we can really help drive better businesses for them. And so it's where when we think about the fintech opportunities more broadly. You heard Tooy comment earlier just about how we can leverage their usage of the software platform to understand when we can best get to them in their moments of needs. We think there are synergies across so many different vectors when it comes to these different fintech core platforms, and it's one of the reasons we think this is an important thing for us to pursue and have a big opportunity ahead.

Craig F. Courtemanche*Founder, President, Chief Executive Officer & Chairperson, Procore Technologies, Inc.*

A

And I love that you ask that question because there is a lot of folks that were calling that are not Procore customers and even collaborators today. So the universe specialty contractors even just the US is enormous. So once we have those conversations and we start providing and becoming the trusted partner through material finance, we believe that there's a lot of opportunity to bring them over to our product line and we believe every subcontractor pretty much in America can benefit from using Procore.

Ken Wong*Analyst, Oppenheimer & Co., Inc.*

Q

Got it. Thanks. Thanks for that color. And then maybe just a follow-up, you guys have consistently highlighted a building pipeline but potentially some bottlenecking because of all the macro factors. Have you started to see that loosen up at all where the deals are starting to flow through a little more in the pipeline? Or is it still feel pretty gummed up relative to past quarters?

Paul Lyandres*Chief Financial Officer, Procore Technologies, Inc.*

A

I would say it looks similar to past quarters. As Tooley has commented, we haven't seen a meaningful shift in the conversation around macro dynamics. We still have supply chain issues. We still have constraints on labor. It's a dynamic environment out there, but customers are coming to us to help make their businesses more efficient to grow. So we believe we are positioned in all these different environments to really be able to deliver value to these different stakeholders and we continue to read the same information you do about the evolution of the world. And so we do believe there are puts and takes of what's going to create constraints and what's also going to loosen that broader pipeline.

Craig F. Courtemanche*Founder, President, Chief Executive Officer & Chairperson, Procore Technologies, Inc.*

A

I will say the overall sentiment of all the folks that I talked to is still remains very optimistic.

Ken Wong*Analyst, Oppenheimer & Co., Inc.*

Q

Got it. Great. Thanks for the color you guys.

Craig F. Courtemanche*Founder, President, Chief Executive Officer & Chairperson, Procore Technologies, Inc.*

A

Nice to meet you, Ken.

Operator: Thank you for your question. And with that, we will conclude today's Procore Technologies, Inc. fiscal year 2022 Q2 earnings call. Thank you for your participation. You may now disconnect your line.

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