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Aritzia, Inc. (ATZ.CA)

Q4 2020 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Welcome to Aritzia's Fourth Quarter 2020 Conference Call. As a reminder, all participants are in listen-only mode and the conference is being recorded. After the presentation, there will be an opportunity to ask questions. [Operator Instructions]

I would now like to turn the conference over to Helen Kelly, Vice President of Investor Relations. Please go ahead.

Helen Kelly

Vice President, Investor Relations, Aritzia, Inc.

Thank you, Anastasia, and thank you for joining us for Aritzia's fourth quarter fiscal 2020 earnings conference call. On the call today, we have Brian Hill, our Founder, CEO, and Chairman; Jennifer Wong, President and Chief Operating Officer; and Todd Ingledew, our Chief Financial Officer. Following management's discussion, we will host a question-and-answer period open to analysts and investors.

Please note that remarks on this call may include our expectations, future plans, and intentions that may constitute forward-looking statements. In particular, COVID-19 continues to have a significant impact on our sales and operations. The uncertain and dynamic nature of current conditions and its ongoing impacts could continue to materially alter our performance. We would refer you to our most recently filed management's discussion and analysis, and our annual information form, which includes a summary of the assumptions, as well as certain material risks and factors that could affect our future performance and our ability to deliver on these forward-looking statements.

Our earnings release, the related financial statements, and the MD&A are available on SEDAR, as well as the Investor Relations section of our website at aritzia.com.

I will now turn the call over to Brian.

Brian Hill

Founder, Chief Executive Officer & Chairman, Aritzia, Inc.

Thank you, Helen. And thank you very much for joining us this afternoon. Like all of you, we at Aritzia extend our deepest sympathy to the many people who have been directly or indirectly affected by COVID-19.

As you all know, the impact to the economy and the retail industry is without precedent. While there is great uncertainty as to how this crisis will unfold, Aritzia's strong financial position and the affinity for our brand provides a firm foundation from which we are weathering the storm.

Looking way back to the fourth quarter, net revenue grew 6.3% to CAD 275 million. Excluding the extra week in the prior year, normalized fourth revenue – fourth quarter net revenue increased by 11.6%. Revenue growth was driven by an 8.9% increase in comparable sales, our 22nd consecutive quarter of positive comparable sales growth, included also the contribution from our five new and four repositioned boutiques. Our performance reflected strong momentum in our eCommerce business with double-digit growth across both Canada and the United States.

In line with the five-year plan we set out for ourselves at the time of the IPO, eCommerce penetration for fiscal 2020 was 23% of net revenues. Toward the end of February, we began to see the impact of COVID-19 on our business. Over the past few months, our teams have worked tirelessly in response to the dynamic nature of the pandemic. Our strategy from the beginning of this crisis has been to both be responsive and responsible, as we prioritize the health, safety and financial continuity of our people and our businesses, while supporting our communities. We made the decision to temporarily close all 96 of our retail locations on March 16.

With retail comprising 77% of our almost CAD 1 billion business in fiscal 2020, this financial impact was significant. Throughout this period, we worked to keep our eCommerce channel operational and optimized. This was critical to maintain our financial viability, as we continued to provide our clients with beautiful products and an exceptional shopping experience online.

Accompanying the shift to work-from-home, we reoriented our merchandise on aritzia.com to lead with product that was relevant to the new stay-at-home measures. This resulted in a meaningful increase to our sales online. In addition, we removed our minimums for free shipping, relaxed our return policy, launched our incredibly successful Thanks To You Sale in late March, and extended the duration of our spring sale in April.

Overall, we are encouraged by the exceptional response from our loyal clients. Even though our overall business was down significantly as a result of our boutique closures, our eCommerce revenue growth has been in excess of 150% compared to last year. Importantly, the strength of our eCommerce business has enabled us to support our people, while maintaining our solid financial position. Up to this point in time, we have not laid off or furloughed any of our team due to COVID-19. To date, we have paid out more than CAD 14 million through our Aritzia Community Relief Fund, which was established to provide financial continuity.

We are proud that we are able to support our people, many of whom are being with us for years, and have been instrumental to our past and will be to our future success. The loyalty we have built with our teams and our clients through this initiative will be invaluable as we go forward.

Leveraging the strength of our brand and our people initiatives, our style advisors quickly became highly effective brand ambassadors through their own social media channels, as well as driving their clients to aritzia.com. Due to the closure of our photo studio, we modified our photography strategy to ensure all our new items are posted online in a timely manner. The relevancy of this strategy to our customers had an overwhelming response as evidenced by strong eCommerce sales.

Furthermore, we wanted to do our part to support our frontline healthcare heroes. By suspending most of our planned marketing spend, we were able to create and launch the Aritzia Community Care Program in early May. The initiative in collaboration with the medical community gives over 100,000 frontline healthcare workers with custom-designed clothing packages. There has been an overwhelming response from the healthcare community and to date, we have gifted over 60,000 relief packages.

The challenging COVID-19 environment has truly brought out the very best in our team, including some of the most creative and engaging marketing we had done to-date. Our efforts were rewarded with deepened customer loyalty, meaningful growth in our eCommerce channel as well as broad positive coverage from The Globe and Mail, Financial Post, Global, CNN and other news media outlets.

Turning to inventory, we were in an optimal position at the end of the fourth quarter. We saw our inventory down 16.2% compared to last year. After the closure of our boutiques, we took immediate action to calibrate our existing inventory and plan deliveries to maximize sales opportunities, whilst minimizing any future exposure. To-date, we have been successful in our efforts to mitigate the impact of delays and disruptions to our supply chain. Since early April, all of our partner factories have largely returned to normal business operations. We will continue to collaborate with our supply chain partners to maximize our agility, while mitigating potential disruptions.

While we enter this period of uncertainty with a reasonably strong cash position, we're focused on carefully managing our costs. In addition to inventory management, we conducted a thorough review of all our expenditures. Where possible, we minimized our expenses, reduced or canceled services, took advantage of government business support programs and have continued negotiations with our suppliers, vendors and landlords for price concessions.

With the end of our first quarter only three days away, we want to provide you with an overview of our preliminary figures, given the material impact COVID-19 has had on our business performance. We currently expect the first quarter fiscal 2021 net revenues in the range of CAD 105 million to CAD 110 million, a reduction of approximately 45% from the first quarter of last year. This reflects two weeks of decelerating retail revenues in March prior to our boutiques closures, and this all offset by strong eCommerce revenues for the quarter.

While navigating the past months has unquestionably been challenging, it has highlighted the strength of our operating model and demonstrated that our approach to business sets us apart and can sustain us through the worst of times. I'm incredibly proud of the team I've had the privilege to work with. Throughout this crisis, our team has acted with courage and heart. I'm grateful for their impression – impressive resilience and creative solutions to unconventional challenges, as they invest in countless hours of tireless work to safeguard our business. I'm confident that the steps we have undertaken and continue to take combined with our talented people, best-in-class infrastructure, will allow us to emerge from this period and even stronger and more resilient company, ready to capitalize on all the opportunities ahead of us.

I will now turn the call over to Jennifer to give you an update on our operations as well as some of the areas in which we are focusing our efforts, as we navigate this period of uncertainty.

Jennifer Wong

President, Chief Operating Officer, Corporate Secretary & Director, Aritzia, Inc.

Thanks, Brian, and good afternoon, everyone. I would like to echo Brian's comments that our thoughts are with those impacted by this pandemic. To say that COVID-19 has challenged our business in the last few months is an understatement. Like Brian, I'm incredibly proud of the dedication, resilience and agility our people have demonstrated in the rapidly changing landscape.

During the closure of our boutiques, we worked to keep all three of our distribution centers open to support our eCommerce channel. While we took early and decisive steps to implement precautionary measures across the business, we re-engineered our distribution operation and put in place industry-leading measures to provide the utmost confidence in ensuring the health and safety of our people.

Our team took on the enormous task of re-sequencing the entire workflow of our 223,000 square foot distribution center in Vancouver. We staggered shifts and implemented both pod structures and designated work zones. We reorganized almost every aspect of how we fulfill from the single point of entry to receiving, picking and packing. Our efforts were successful in keeping our people safe and our business running without impacting productivity or efficiency. I'm proud to say that as a direct result of these measures, we have not had a single case of COVID-19 to-date, knock on wood. And we will continue these strict health and safety protocols for the foreseeable future.

In order to accommodate the significant surge in eCommerce units, we mobilized nearly 400 of our retail and support office employees in a highly accelerated timeframe to complement our existing team. Trained in under three hours, these employees were held to the same high standards as our tenured distribution employees, and they delivered. Without their help, it would have been a challenge to effectively manage the increase in eCommerce units, while maintaining delivery time to meet or exceed our clients' expectation.

In addition to supporting our distribution operation, 175 retail and support office employees were also redeployed across the country to reinforce our Concierge teams, who are experiencing a significant increase in inbound inquiries as a result of the strong performance in our eCommerce channel.

In British Columbia, we consider ourselves very fortunate with our healthcare leadership and the corresponding relative well-being of our community. As a result, starting June 1, our support office team, who has largely been working offsite since mid-March, will gradually return on a voluntary basis to our Vancouver support office under stringent health and safety precautions.

As Brian touched on earlier, we have not laid off or furloughed any of our employees to-date due to COVID-19. Not only is this the right decision by our people, it is also in keeping with the ritziest operating philosophy to manage for the long term. By keeping our people employed and actively engaged, we retained our key talent and put ourselves in a strategic position to reopen each of our boutiques within days' notice once we have determined the time is right.

While we expect to rightsize our infrastructure once clarity on a new normal emerges, we continue to opportunistically acquire key talent. The strength of our business model and the measures we have undertaken to care for our people positions us as an attractive employer in our pursuit of top candidates in this environment.

Looking beyond the crises, we are positioning ourselves for opportunities. To support our eCommerce channel and advance our omni-channel capabilities, we prioritized our investment in digital selling tools. Also known as a Clientele app, we have been piloting this new selling tool since May 11. This exciting new tool allows our style advisors to deliver highly personalized service to their clients anywhere, anytime.

The initial app launch features functionalities such as the ability to view client profiles and purchase history, product catalog and inventory data, the means to interact by call, text, or e-mail, and the ability to curate looks and share styles with clients, all driving traffic and sales to Aritzia.com. With an initial pilot group of 25 stylists connecting with their top clients through the Clientele app, we have already seen some encouraging early results. It is incredibly impressive that our teams have been able to pivot and get this capability up and running in record speed.

Based on the early success, we are in the process of expanding our pilot group. As we continue to use the tool and gain valuable feedback from our stylists, we will further enrich its capabilities. We expect the tool to increasingly contribute to top-line growth with the expansion of the stylists group and as our clients increasingly appreciate both the convenience and the quality of the personalized experience.

Despite the challenging environment, we continue to invest in people and the critical infrastructure to support our business as we have always done throughout Aritzia's history. We expect these initiatives will strengthen our culture and have a meaningful positive impact on our business and our long-term growth strategies.

I will now turn the call over to Todd to discuss our financial results.

Todd Ingledew

Chief Financial Officer, Aritzia, Inc.

Thank you, Jennifer. Good afternoon, everyone. I hope you and your families are staying healthy and managing through these times. In response to the COVID 19 outbreak, we acted quickly to safeguard our business by enhancing liquidity, managing expenses and protecting cash. Before I provide more details on the actions we've taken, I will share a few highlights from the fourth quarter and for the full year fiscal 2020. My financial review will be focused on the comparative figures, which exclude the impact of IFRS 16.

The strong momentum in our business continued into the fourth quarter with comparable sales growth of 8.9%. Excluding the extra week last year, net revenue grew 11.6%. Gross profit margin in the fourth quarter was 35.3%, down 90 basis points from last year primarily from the expected higher raw material costs and the impact from the new US tariffs, as well as slightly higher markdowns and increased warehousing and distribution center costs. These impacts were partially offset by the appreciation of the Canadian dollar in the fourth quarter versus last year.

SG&A expenses increased by 8.6% to CAD 64 million. SG&A expenses were 23.4% of net revenue compared to 22.9% last year. The increase was primarily attributable to CAD 2 million of investment in our new customer program. Excluding this investment, SG&A would have seen a 20-basis-point improvement over last year. These factors resulted in adjusted EBITDA that was essentially flat to the fourth quarter last year, which benefited from the extra week.

Inventory at the end of the fourth quarter was CAD 94 million, a 16.2% decrease compared to CAD 112.2 million at the end of the fourth quarter last year. The decrease reflects a lower initial buy for the spring/summer season as well as early receipt of inventory in the same period last year.

As Brian touched on earlier, fiscal 2020 reflected continued momentum for Aritzia. We delivered net revenue growth of 12.2% to CAD 981 million for the full year. Normalizing for the 53rd week in the prior year, net revenue increased 13.7%. In particular, we are pleased with the acceleration of our business in the United States with revenue growth of 29.4%, driven by both strong eCommerce and boutique performance.

Adjusted EBITDA grew 7.2% to CAD 173 million or 17.6% of net revenue compared to 18.4% last year. Adjusted EBITDA was impacted by the CAD 7.3 million investment in our customer program, as well as a CAD 4.8 million reduction in other income year-over-year. Excluding these amounts, adjusted EBITDA would have increased by 14.7%. Overall, we ended the year in a solid financial position with a cash balance of CAD 118 million.

Turning to our performance in the first quarter of fiscal 2021, we saw a rapid deceleration of our business in the first two weeks of March as the pandemic spread across North America. With the closure of our boutiques on March 16, we immediately directed our efforts to drive eCommerce revenue. In addition to generating cash, this enabled us to continue to sell through our inventory. Furthermore, we took swift action to enhance liquidity, manage expenditures and preserve our solid cash position.

Some of the initiatives included drawing down CAD 100 million from our revolving credit facility, suspending share repurchases under our NCIB, leveraging applicable government business support programs for COVID-19, delaying capital expenditures related to boutique construction, accelerating infrastructure investments related to eCommerce and omni-channel projects, reducing and/or eliminating any outstanding spring/summer orders, driving cost reductions by minimizing non-essential operating costs as well as ongoing negotiations with our suppliers, vendors, and landlords for concessions, extending net payment terms where possible, and temporarily reducing pay for the senior leadership team by 25% and the forfeiture by the board of directors of the cash portion of their fees.

Looking forward we expect first quarter fiscal 2021 net revenues to be in the range of CAD 105 million to CAD 110 million compared to CAD 196.7 million in the first quarter last year. Again, this reflects two weeks of decelerating boutique revenue in March prior to the closures and exceptional eCommerce revenues. For context, in the first quarter last year, our boutiques contributed nearly 80% of our total net revenue. We anticipate an adjusted EBITDA loss in the range of negative CAD 24 million to negative CAD 28 million compared to positive adjusted EBITDA of CAD 34 million in the first quarter last year. This reflects the closure of our boutiques for the majority of the quarter and the associated deleverage from occupancy and other fixed costs. In addition, higher markdowns from the promotional environment and increased warehouse and distribution costs due to the significant growth in eCommerce are impacting our results.

We are pleased with our current inventory position due to the strength of our eCommerce business and the substantial sell-through of markdown product in the first quarter. We initiated our spring/summer sales event in the third week of May, which has helped us continue to work through inventory as our boutiques begin to reopen. In addition, our ability to carry forward our non-seasonal proven sellers into the fall season enabled us to reduce our initial fall/winter orders. Despite plans to enter the fall season with a lower initial buy, we are confident in our abilities in-season to replenish our product to meet client demand. Our measures to protect cash have resulted in a cash balance that has remained relatively stable since our boutique closures. As of May 27th, our net cash totaled CAD 102 million excluding the CAD 100 million drawn from our revolving credit facility.

Prior to COVID-19, we were on track to exceed our fiscal 2021 targets related to the five-year plan we set out at the time of our IPO. Due to the dynamic nature of our – of COVID-19 and the short-to medium-term effects on the consumer landscape, we are withdrawing our performance targets for fiscal 2021 and will not be providing annual guidance at this time. Despite the challenging backdrop, we were able to accelerate our eCommerce revenues, manage expenditures and preserve our strong cash position in the first quarter to successfully safeguard our business. We expect to end the first quarter in a solid inventory and cash position as we continue to navigate the current environment.

With that, I'll turn the call back to Brian.

Brian Hill

Founder, Chief Executive Officer & Chairman, Aritzia, Inc.

Thank you, Todd. Throughout these highly uncertain times, we have remained true to our commitment to everyday luxury through our beautiful, high quality products, our unique personalized services to clients, an aspirational shopping environment whether that be online or in our boutiques, and engaging communications to captivate our customers' imaginations. The challenging environment and corresponding boutique closures have had, and will continue to have a material adverse impact on our fiscal 2021 performance. However, it gives us tremendous confidence in the strength of our business model and in particular the strong momentum in our eCommerce channel. We fully expect that a portion of our retail business will permanently shift offline – online.

As Jennifer outlined earlier, we continue to invest in digital selling tools and expanding our omni-channel capabilities to better position Aritzia to serve our clients in this evolving retail landscape. As of May 7th, we began a phased reopening of our boutiques. As of this coming Sunday, which marks the end of our first quarter, we expect to have reopened approximately 30 of our 96 boutiques. While initial results from the reopening process are encouraging in light of the current environment, we expect an extended ramp to a new normal.

Our decisions on reopening are based on a number of criteria including the guidance of local health authorities, the reopening status of shopping centers, and most importantly, our own state of readiness to provide the highest standards of health and safety. To that end, we have put in place comprehensive measures designed to protect and build confidence with our people and our clients. Our teams are anxiously awaiting to welcome back our loyal and passionate Aritzia clients with the reopening of the remainder of the – our boutiques over the coming weeks.

Due to the crisis, we paused our imminent and future boutique opening schedule. However, we've since resumed, having a surprisingly successful new boutique opening in British Columbia yesterday. We currently have five to six additional new boutiques and three to four repositionings in our pipeline. However, due to ongoing disruptions, we could potentially see some delays. Given our measured approach and the status of the various lease negotiations, we have managed to mitigate most all of the risk of the aforementioned commitments. Although it's too early to predict when and how much traffic will return to retail, we continue to be presented with premier locations at financially attractive business terms. We are evaluating these on a case by case basis as this crisis continues.

Notwithstanding my prior comments regarding our inventory levels, our product team has been operating both in the office and remotely to support our seasonal design and production lifecycle, minimizing impacts to future seasons. As mentioned, we have taken a methodical approach to ensure our fall/winter inventory levels and assortment are well-balanced. While we have reduced the breadth of our assortment, the offering is being carefully curated to provide freshness to our customers as they emerge from a long period of isolation.

While I expect the lingering effects of an elevated promotional environment to last through the remainder of the spring/summer season, we'll be reverting to our successful full price calendar for fall/winter and will take a disciplined approach to how we manage promotions in the future.

This marks our fourth yearend report as a public company. Almost four years ago, we set out some five-year targets around eCommerce penetration, door openings, revenue and EBITDA growth. It is particularly disappointing, as we are well on our way to exceeding these targets prior to COVID-19. Although the retail landscape for the remainder of the year and possibly the beginning of next is uncertain, the recent acceleration of our eCommerce growth, our boutiques in the midst of reopening, building on our existing world-class team with

top talent hiring opportunities, and our ability to deepen our relationship with our clients makes for an exciting future. I can think of no better team than the one we have at Aritzia to capitalize on the opportunities ahead.

I look forward to sharing our new long-term outlook with you once the new normal has been established. Thank you.

QUESTION AND ANSWER SECTION

Operator: We will now begin the question-and-answer session. [Operator Instructions] Our first question comes from Mark Altschwager with Baird. Please go ahead.

Brian Hill

Founder, Chief Executive Officer & Chairman, Aritzia, Inc.

A

Mark, we can't hear you if you're talking. Operator, why don't you go to the next person in the queue?

Operator: Apologies sir. Our next question is from Mark Altschwager with Baird. Please go ahead.

Brian Hill

Founder, Chief Executive Officer & Chairman, Aritzia, Inc.

A

I think that's who we were just trying.

Mark R. Altschwager

Senior Research Analyst, Robert W. Baird & Co., Inc.

Q

Yeah, Todd, can you hear me?

Brian Hill

Founder, Chief Executive Officer & Chairman, Aritzia, Inc.

A

Okay, yeah, we can now.

Mark R. Altschwager

Senior Research Analyst, Robert W. Baird & Co., Inc.

Q

Okay. I don't know what was going on there. Great, well I was – I wanted to ask about the reopening process and just any further detail you can provide on the level of productivity you're seeing in your stores as the first wave has opened and any more detail on how many stores you expect to have open by the end of June and July respectively? And also, what the digital has looked like as stores have reopened? Has that moderated at all? Thanks.

Brian Hill

Founder, Chief Executive Officer & Chairman, Aritzia, Inc.

A

Yeah. Mark, it's Brian. We've put a very high bar in all of our precautions we are – in opening up our stores and I think the customers have felt really comfortable in our stores. We have limited the amount of people in the stores. We have a criteria that we've rolled across all our stores. Some of the stores we've had more or less continual line-ups at since we've opened. But you know, like everything that we've seen with this pandemic, it seems to be affecting everybody – in every place differently than others. And so because of that we're expecting to see

different responses from our customers depending on where they are. Where we're situated in British Columbia, we've had very little effects of this disease compared to places like New York and in particularly Eastern Canada and specifically Québec. So, we've only really opened up pockets of stores, primarily Western Canada at this point in time which has not been affected and so the response has been very, very surprisingly really great for opening stores. But we're still – we still don't know when we'll be able to open a bulk of our stores in Ontario. We have a huge – obviously, business in Manhattan and New York. We don't know when those are opened. So, we don't know when they're going to be opening. But all I can assure you is that we will be opening them very quickly once we get the green light and that they will be opened under the most stringent health and safety precautions when they do – when they are opened.

Mark R. Altschwager

Senior Research Analyst, Robert W. Baird & Co., Inc.

Q

That's very helpful. Thank you. And if I could follow up, how do the store level economics change if the new normal is a step function lower in store productivity and a step function higher in digital? And along those lines, wondering if there is any color you can provide on the conversations you are having with landlords relative – or whether respectively, negotiating some of your existing leases – or how are you looking to approach rent terms on the new boutique openings moving forward?

Brian Hill

Founder, Chief Executive Officer & Chairman, Aritzia, Inc.

A

It was a lot of questions there. I'll try and answer a few of them, no particular order. We've had ongoing discussions with the landlords. This has been a difficult period for the landlords as well and so we certainly understand that they are in a difficult position. So, we've been working closely with the landlords. We haven't come to any conclusions yet really with any of the big landlords. Some of the more independent landlords has been easier, but [indiscernible] (00:35:25) to come in some kind of a resolution on rent and it's been varied. But the big landlords in – both in Canada and the United States, it's been difficult for them and difficult for us. And we haven't really concluded on where we're going to net out here. And so we've just been working closely – calls with them almost daily, and we're working through those.

As far as numbers go, we have extremely high productive stores and so we're pretty confident that even with some new normal, it isn't at the same levels that we had before. We will still have extremely profitable stores and they round up – round out the omni experience for us. So, we don't really see us getting to close any stores. They are all extremely profitable, high contributing stores. And so, we look forward to continuing that. And as we've mentioned in the call, we're going to continue to push our eCommerce. We think we're best-in-class at this right now and our numbers show it and our customers are saying it. And so, we're going to continue to invest and pushing eCommerce. So at the end of the day, we think we've got a great future ahead of us regardless of what the store outcomes and what happens – what the return to new normal is in retail.

Mark R. Altschwager

Senior Research Analyst, Robert W. Baird & Co., Inc.

Q

That's great. Thanks for all the color and best of luck with the re-openings.

Brian Hill

Founder, Chief Executive Officer & Chairman, Aritzia, Inc.

A

Thank you.

Operator: Our next question is from Mark Petrie with CIBC. Please go ahead.

Mark Petrie

Analyst, CIBC World Markets, Inc.



Hey, good afternoon. Obviously, I appreciate that it's very difficult to give an outlook given all of the uncertainty. But wondering if you could just give a bit more granularity in terms of Q1 since we're there and that period's basically complete just in terms of gross margin and OpEx. And then any outlook you can provide in terms of how you expect your operating cost to be able to flex through the rest of fiscal 2021.

Todd Ingledew

Chief Financial Officer, Aritzia, Inc.



Hi, Mark. It's Todd. We will continue to see a decline in our gross profit in Q1 and for the rest of the year. Given the promotional environment, we continue to expect pressure from higher-than-normal markdown levels. We're also seeing pressure from the weakness in the Canadian dollar and then the continued de-leverage from rents. We have a portion of our boutiques that are open now but the majority's still closed. And we do expect lower productivity at the reopen, at least in the short term. And then we will also continue to see higher warehousing and distribution cost as we're driving more sales through the eCommerce channel. So, there are numerous pressures on gross profit in Q1 that are driving the outlook that we provided.

And then going forward, we do expect in the short to medium term the majority of those pressures to continue. It's a little early and just we aren't in a position right now to provide an outlook going forward beyond that. We are expecting, again, a ramp as we open the stores, but it's too difficult given the environment to predict exactly what the remainder of the year will look like at this point.

Brian Hill

Founder, Chief Executive Officer & Chairman, Aritzia, Inc.



Can I add to that a little bit? And thanks for that, Todd. I'll just say one thing, because I look after the product division. So, we obviously didn't predict COVID and we had purchased a lot of product for a normalized spring and summer season. That takes us through the first and second quarter. So, we are extremely happy with where we started, and we talked about it on the call. We started with less inventory this year beginning in the first quarter and in the second – and we're extremely pleased with where we're netting out right now. We actually have less discontinued merchandise right now than we did this time last year with 10 weeks where our teams have done such a good job.

That said, we've used promotional activity to get ourselves in that position. And we've always had the philosophy at Aritzia to start new seasons with as clean a stock as possible and ideally 100% clean stock, so not having any inventory left over to start the new season and carry the new season over. And that has not changed. So, we're doing whatever we can do.

The difference with Q1 and Q2 versus Q3 and Q4 is Q3 and Q4 we've been able to affect not all our Q3 deliveries but certainly quite a few of them and we can certainly – have been able to edit our Q4 deliveries. So we think that our gross margin due to all the markdown activities, due to the fact we had so much merchandise purchased in Q1 and Q2 is not going to be that pretty, but we believe that Q3 and Q4 will actually be better.

Now where it actually nets out, we don't know yet at this point in time because it's been so difficult to predict where our business is going to be and how much inventory we're going to need. So that's been sort of more of an organic situation, whereas Q1 and Q2, we know exactly what we're dealing with here and we've been doing whatever it is to get through our inventory.

Mark Petrie

Analyst, CIBC World Markets, Inc.

Q

Okay. No, that's very helpful commentary for sure. I guess, maybe just back to the SG&A, I don't know if it's possible to sort of quantify some of the elevated cost of operating through the course of the pandemic, maybe specifically with – in terms of eCommerce fulfillment or the DCs or if you can quantify the impact of the government support programs that you participated in.

Todd Ingledew

Chief Financial Officer, Aritzia, Inc.

A

Yeah, we are expecting to receive approximately CAD 6 million for each month that we qualify from the government support programs that's both in Canada and the US. So that is obviously a major contributor to our decline in – supporting a decline in expenses in SG&A, but we have, again, significant increases in other areas. So, we're really too early in the game to exactly know the pressure going forward from the additional measures that we're putting in place at the stores. It will be primarily from increased labor and then increased cleaning and protective equipment but primarily labor. So, again – and, Mark, I apologize that we don't have specific guidance to provide, just to say that we have meaningful pressure from the normal that we'll be operating under going forward from an SG&A perspective.

Brian Hill

Founder, Chief Executive Officer & Chairman, Aritzia, Inc.

A

Yeah, if I could – it's Brian here. I could add to that, too. We are receiving some government support, but the purpose of the government support was to ensure that people stayed employed, and that's exactly what's happened at Aritzia is that it is giving us the ability to keep our people employed and that's why – that was the intent of the government support and it's working. The federal government support with labor is working as per – at Aritzia.

Mark Petrie

Analyst, CIBC World Markets, Inc.

Q

Okay, thanks. And then just last, I'm wondering if you could just provide some additional color or commentary about any differences in behavior or sort of consumer patterns you're seeing in the US versus Canada? And just curious if there is a difference, just given the difference of where you are in terms of brand equity and also new customer potential.

Brian Hill

Founder, Chief Executive Officer & Chairman, Aritzia, Inc.

A

Sorry, can you clarify that? So, you're wanting to – can you repeat that question, please?

Mark Petrie

Analyst, CIBC World Markets, Inc.

Q

Yeah, I'm just wondering if you're seeing any difference in terms of how customers are reacting to the different levels of promotion and how you adjusted the assortment between the US and Canada, understanding that it's just a different level of brand equity, different level of brand awareness and obviously in US there is a huge opportunity to build new customers, whereas in Canada it's more about selling more to the people you already sell to.

Brian Hill

Founder, Chief Executive Officer & Chairman, Aritzia, Inc.

A

Yeah, we've been very encouraged that we're building a lot of new customers in both Canada and the US and as you suspect, a few more in the US. But we've been building new customers that previously had not shopped online with us before. We're sure they've shopped in our stores, but they previously haven't shopped online with us. And as you know, the customers that use both channels or multiple channels are better customers and spend more money and are more engaged than ones that just use a singular channel. So, that's been extremely encouraging for us.

We haven't noticed as much of a difference in Canada versus the US as we net – very seldom do in our business. It's mostly a East Coast to West Coast and with this pandemic, it depends where people have been hit the hardest is where we've found that our sales are being affected differently.

And then really with a product perspective, the products that are being purchased are different. People are at home, they're not going out and so all our products that are more lifestyle based, comfort based, athletic based are being – have had a lot more attention than ones that have been – dresses and things like that for people that have been going out and professional wear for people going to work in the office. So that's all changed a little bit. And – but we are seeing a shift now that some of the isolations are being relaxed a little bit, we're seeing a little bit – we're seeing a change again here. But – so we've seen a bit of a mix in our product that we're selling and fortunately through our product mix, we appeal to a lot of different people with a lot of different types of products and that's done well for us and played into our strengths here.

Mark Petrie

Analyst, CIBC World Markets, Inc.

Q

Appreciate all the comments. All the best.

Brian Hill

Founder, Chief Executive Officer & Chairman, Aritzia, Inc.

A

Thank you.

Operator: Our next question is from Irene Nattel with RBC Capital Markets. Please go ahead.

Irene Nattel

Analyst, RBC Capital Markets

Q

Thanks and good afternoon, everyone. I want to really, really thank you for all of the color around the performance and congratulate you on your performance through this very challenging period. I actually wanted to start, if you don't mind as a follow up to that last answer Brian. You do have this very broad offering. As you thought through your spring and fall – sorry, your fall and winter mix, did you make any adjustments for what's likely going to be an extended period of work-at-home and maybe some different – and different purchasing patterns?

Brian Hill

Founder, Chief Executive Officer & Chairman, Aritzia, Inc.

A

Irene, thank you for the comments and thank you for joining us. It's been interesting because it's – on one hand we think, okay everybody has shifted indoors and therefore we should have more of that product. And then one could argue that everybody has bought all that product and those people want to go outdoors now and start going out and being in restaurants and things like that in the fall as things are being relaxed. We are thinking, maybe,

people, because they haven't purchased any of these other products might want to kind of purchase these other products. So, we've been having an internal debate: are people going to be buying more things for – to stay at home because they're spending more time at home, or is that all they bought and so they actually want some freshness to their closet on going out. So, we haven't really drawn a conclusion and as I mentioned, fortunately we are able to do both. So we are continuing on doing both and making sure that we're balanced there.

But as Todd laid out is that we are being very conservative [indiscernible] (00:48:30) purchases for fall and winter where we can have it committed and then we're going to scramble as sales continue to grow and as – the new normal as we get closer and closer on the ramp-up. So we're really, really comfortable with our inventory positions right now and where we're looking for fall and winter. Obviously the business climate is challenging and we're not thrilled with that, but it is – that's the card – the hand we're all being dealt with right now and so we're making the best of it. And I'm pretty comfortable what the team has done to get us in the position here. And as I say, I don't have a read right now on whether people are going to be purchasing more in-home or not. My sense is that they're ordering online. They're going to be purchasing more from their home. But if they're actually out and in the stores, it means that the confidence within areas that are faring a little bit better, my sense is that they are going to be held buying those kinds of clothing. So, it's hard to say where we're going to net out right now. And all I can say is we're covered for both scenarios.

Irene Nattel

Analyst, RBC Capital Markets



That's very helpful. Thank you. And, yeah, I wish we all had a crystal ball. As you think through the different reason in which the impacts were – have been felt, does it change at all your thinking around store size maybe a little bit bigger so that you can accommodate greater sort of distancing in the stores. Do you think about mall versus streetscape a little bit differently, as you're now looking at some of these real estate opportunities?

Brian Hill

Founder, Chief Executive Officer & Chairman, Aritzia, Inc.



That's a great question and we've been discussing the same thing in our office. With more people working work from home, does that mean we need more office space or less office space? Because people will also want to have a little bit more space for themselves and a little bit more room. The good news with the stores are is that we've been opening a nice comfortable amount of stores forever it seems, and we're not all of a sudden in a position to be restored. I would argue we're still unrestored at Aritzia. We still have lots of opportunities.

I think with the new retail, if we thought that we are in an enviable position in an ability to open up stores prior to this crisis, we certainly are again more so now going forward, because we're going to be one of the few companies that's out still looking at opening stores. So, we're going to be taking one day at a time. We don't know what this new normal is and we're going to wait to see this before we really commit to anything.

And we're going to start to know here. I mean, it seems forever, because we've been cooped up indoors, but at the end of the day, it's really only being three months here that – around just over two months that we've been operating like this. So, come the fall and we'll see what's happening with the retail landscape. We'll have a far better read. As I mentioned, we only have 30 stores, majority of those have only been opened in the last week or so, 10 days. So we're going to have a fairly good read next time we speak to everybody three months from now on exactly what it is that we're dealing with, and we'll probably have a far more solidified plan at that point in time.

Irene Nattel

Analyst, RBC Capital Markets



That's great. Thank you.

Operator: Our next question is from Derek Dley with Canaccord Genuity. Please go ahead.

Luke Hannan

Analyst, Canaccord Genuity Corp.

Q

Thanks. This is Luke on for Derek. One thing I was curious about. As you sort of work through gain of Q1 here, obviously eCommerce is at 23% of all of sales in fiscal 2020. I'm just curious where that sort of penetration has trended through the quarter-to-date?

Todd Ingledew

Chief Financial Officer, Aritzia, Inc.

A

Yeah. Obviously, our stores have been closed for the majority of the quarter. This quarter – this Q1 started in the beginning of March and is ending on Sunday. So the majority of our sales in the quarter are coming from eCommerce.

Luke Hannan

Analyst, Canaccord Genuity Corp.

Q

Right. As you – where are your distribution centers, where they're at now? And as you think about maybe that permanent shift towards having customers who are buying online as opposed to in-store, are you sort of comfortable with the capacity and the throughput that you're able to pull through those distribution centers, or are you thinking that there might need to be some sort of expansions or something of that like moving forward?

Jennifer Wong

President, Chief Operating Officer, Corporate Secretary & Director, Aritzia, Inc.

A

Hi. Luke, it's Jennifer. On some of the previous calls, I have spoken to our distribution center expansions, we recently expanded the square footage in the Columbus distribution center as well as the Mississauga distribution center and as you know we moved into [ph] Boeing (00:53:25) just a couple of years ago. So when we were doing our numbers then, we were anticipating growth in our business. And so at least for the time being, we believe that we have enough faith. But I do think we will be looking at as we – as I mentioned, we re-engineered pretty much our work flow and our processes is that we will have to make some redesign tweaks and changes within the building to accommodate for what we're putting through the buildings as well as for the new normal of social distancing and so on and so forth.

Luke Hannan

Analyst, Canaccord Genuity Corp.

Q

Understood. And then, so last one for me. Just I guess thinking about eCommerce as far as maybe some metrics as regarding maybe new customer conversions or retention or any metrics like that to maybe show the performance of eCommerce sort of pre-COVID related shutdowns versus sort of where that performance and eCommerce is as of today?

Todd Ingledew

Chief Financial Officer, Aritzia, Inc.

A

Well, I think, as Brian mentioned in his prepared remarks, we have seen a significant acceleration in our eCommerce business since the store closures, up over 150%. So we're very pleased with where that's been pacing. And also extremely pleased with the teams and the way that our distribution center and our call center

staff have been able to handle the additional volume. So, we went from in beginning of March a period that is somewhat of a slower period, let's call it, for eCommerce to effectively the play-offs and a Black Friday type revenue or a sale season type revenue and our teams managed it flawlessly. So we – that's what's been happening with eCommerce. I mean, it's increased dramatically since the store closures.

Luke Hannan

Analyst, Canaccord Genuity Corp.

Q

Okay. Thanks. Appreciate the color.

Operator: Our next question is from Stephen MacLeod with BMO Capital Markets. Please go ahead.

Stephen MacLeod

Analyst, BMO Capital Markets Corp. (Canada)

Q

Thank you. Good evening. Good afternoon. I just wanted to talk a little bit about the store openings. You mentioned that – can you just throw some color. You mentioned that the initial results were – have been encouraging. So that will be the first question, maybe how that's trending? And then you talked about planning for an extended ramp and I'm just wondering if you can give us a bit of color on how you're timing in terms of that ramp to work?

Brian Hill

Founder, Chief Executive Officer & Chairman, Aritzia, Inc.

A

Thank you, Stephen. Well, I'll go in reverse order. So, we don't know what this ramp is going to look like. We're just preparing for a long slow ramp. And there's two portions to that ramp. One is how slow the ramp is and over what period of time. So is this going to be – are we going to see this ramping up right through to September or October, and some people are – in various places in North America are obviously and deservedly, so pretty shook up by this. So are they going to be jumping and going out to stores at the same level they were before? Probably not. And will they eventually? I don't know.

And so, we're going to see this ramp. We were predicting this ramp to the end of this year, and as I mentioned in our remarks, probably in the first quarter of next year as well. So we're preparing for a long slow ramp to new normal. And then the second part of that is in new normal and what that's going to look like, and we don't know what that's going to look like either. I mean, are we going to ramp to 70% of our previous sales in the stores, 80%, 90% 100%, I don't know. And so, we're going to – we're prepared in whatever scenario we see and then we'll go from there. But the good news is, as mentioned with the last question is that we have a robust eCommerce business that we think if regardless of whether that equilibrium is tilted one way or the other, we have a very good presence in both those scenarios.

What's the second part of your question?

Stephen MacLeod

Analyst, BMO Capital Markets Corp. (Canada)

Q

The second part was just with respect to what you're seeing in terms of initial results from new re-openings?

Brian Hill

Founder, Chief Executive Officer & Chairman, Aritzia, Inc.

A

Yeah. It's hard to see, hard to tell. We found our storefront, street-front stores to probably being a little bit busier than a shopping center or mall stores. We've found that the places that are being affected less have had a little bit more pickup and uptick than the ones that have been affected more. And then, there's obviously limitations in the stores themselves as far as capacity goes and line-ups and fits and things like that.

So, it's been – it's going to take us a while to figure this out. If I say some of the stores have been – only been opened 10 days, and because the outdoor stores have had a little bit more pickup than otherwise, they're being weather-dependent. So on a bright sunny day, our outdoor [ph] robs on the street (00:58:55) and some of the other outdoor stores have been extremely busy. And then the days it's raining, they get affected by them since a lot of those are the ones that are open. We've seen a little bit of mix here and there.

So all I'd say, overall, we've been very encouraged by the response, both from our customers and our teams as far as stepping up and making sure that everybody is safe in the stores. And we've been pleased with the sales and the reaction to-date and we'll continue to monitor that. And as I mentioned, on the next call, we'll probably have a far better idea on how that's – what that's going to look like.

Stephen MacLeod

Analyst, BMO Capital Markets Corp. (Canada)

Q

Yeah. Okay. That's great. Thank you. And then maybe I just wanted to clarify almost Fall/Winter orders. Can you just talk about kind of where you are in terms of your selling season and your ordering season?

Brian Hill

Founder, Chief Executive Officer & Chairman, Aritzia, Inc.

A

Specifically, well, our selling season, we consider fall to start at the beginning of August. It has a slow uptick, because parts of Canada and places is only starting to get warm in some cases, but that's when our fall starts. And – but that ordering seasons what's happening, we had already committed to fabrications and raw materials and things like that prior to COVID even hitting here.

So, we were able to probably affect 50% – maybe somewhere between 25% and 50% of our fall orders, but we are fully in effect for our winter orders. So, we're going to probably – if we could do this all over again, we probably slightly tweak our orders on where we're at right now. But at the end of the day, we're pretty confident with fall and winter. As I mentioned, we started ordering fall on raw materials back in February – January, February, and – but we were able to catch a lot of them, because it was fairly clear what was happening to us in March and we reacted extremely quickly to adjusting those orders as best we can, set new sales targets.

And – but at that time, we still didn't even know if our stores would be open. And we didn't know at that point in time beginning in March if there's a two-month, three-month, six-month closure. We were running – we even had a perhaps closure – assuming a 12-month closure of stores. So we were running all those. So it's pretty difficult, we put through the hold on those March orders, but with the ones we just had holds on that until we got a bit of a clear picture, which we've been getting over the last – almost on a daily basis, but particularly over the last three, four weeks.

Stephen MacLeod

Analyst, BMO Capital Markets Corp. (Canada)

Q

Right. And then in terms of winter, you have – you have had – you had time or you have – you will have time to adjust your winter orders as necessary?

Brian Hill

Founder, Chief Executive Officer & Chairman, Aritzia, Inc.

We've kind of adjusted them now where we placed in a lot of our winter orders now. And so we're adjusting them, and so we're being quite very conservative on those buys and then we're going to scramble the businesses meaningfully better, which we hope it is than we predicted. So we're not going to go and get stuck being overstocked for Fall/Winter. I think Spring/Summer, we have a legitimate reason, Fall/Winter I'm not sure we do. So we're making sure that Fall/Winter we have a nice base of inventory, both making sure given core carryover inventory as well as our new items to delight our customers and new trends and things like that. And so we're doing that. And then, we'll adjust as we see on a weekly and monthly basis as the time goes on here.

A

Stephen MacLeod

Analyst, BMO Capital Markets Corp. (Canada)

Okay. That's great. That's it for me. And thank you for all the color you provided. And best of luck.

Q

Brian Hill

Founder, Chief Executive Officer & Chairman, Aritzia, Inc.

Thank you.

A

Operator: Our next question is from Brian Morrison with TD Securities. Please go ahead.

Brian Morrison

Analyst, TD Securities, Inc.

Hi. Thank you. I just want to follow a few housekeeping items here. Just in terms of the stores. The new stores that you're going to be opening in fiscal 2021, are the remainder of those in the US and of your current store base, how many of those are in the closed malls?

Q

Todd Ingledew

Chief Financial Officer, Aritzia, Inc.

We're planning to open again five to six new stores through the rest of the year. So that'll be six to seven in total new stores for the year. Five of those are in the US. Two of them are in the first half of the year, and we just opened one yesterday and then the remainder of the new stores are all in the back half of the year. From an expansion perspective, we're planning to open for expanded locations, one in the US and three in Canada and one to two of those will be in the first half and then the remainder in the back half.

A

Brian Morrison

Analyst, TD Securities, Inc.

And if you could...

Q

Brian Hill

Founder, Chief Executive Officer & Chairman, Aritzia, Inc.

And – sorry, as far as indoor, outdoor, I think it was kind of where you were driving there [indiscernible] (01:03:46), yeah. So the one we opened yesterday is an outdoor shopping center. I believe, we have – Todd, do you have a count on the indoor, outdoor? I know we have one in the East Coast that's outdoor as well.

A

Brian Morrison

Analyst, TD Securities, Inc.

Sorry, Brian, I'm talking about your current store base.

Q

Brian Hill

Founder, Chief Executive Officer & Chairman, Aritzia, Inc.

Sorry. Of the existing store base, how many are shopping centers versus outdoor?

A

Brian Morrison

Analyst, TD Securities, Inc.

Correct.

Q

Todd Ingledeu

Chief Financial Officer, Aritzia, Inc.

I believe it's about 15 that are street-based and the rest are...

A

Brian Hill

Founder, Chief Executive Officer & Chairman, Aritzia, Inc.

No, no. I think we're a lot higher than that, Todd, because our store in L.A. is – we don't have that number at this point in time, but if you want we can share it offline with you.

A

Brian Morrison

Analyst, TD Securities, Inc.

Yeah. That's no problem.

Q

Brian Hill

Founder, Chief Executive Officer & Chairman, Aritzia, Inc.

Yeah. Because some of them are street-based, but we have a lot of – we have a bunch of malls or stores in shopping centers that are outdoor shopping centers as well. They're just part of a shopping center, but they're full open-air shopping centers.

A

Brian Morrison

Analyst, TD Securities, Inc.

Okay. And then Todd, just in terms of the government assistance that you mentioned, how are you recognizing that in your Q1 financials? Is that a contra expense, or how does that flow through?

Q

Todd Ingledeu

Chief Financial Officer, Aritzia, Inc.

Yeah. Yeah. We've approved for it in our projections.

A

Brian Morrison

Analyst, TD Securities, Inc.

So that will be an offset to your SG&A?

Q

Todd Ingledew

Chief Financial Officer, Aritzia, Inc.

Yeah. It'll be an offset to our labor.

A

Brian Morrison

Analyst, TD Securities, Inc.

Okay. Thank you. And then last question, maybe for Jen. I'm wondering if there's any sort of breakdown you guys have internally of as a percentage of your sales. How you break it down by segments? How much might be at leisure versus denim versus evening wear. Do you have any color on that you can share with us?

Q

Jennifer Wong

President, Chief Operating Officer, Corporate Secretary & Director, Aritzia, Inc.

I'm going to have Brian answer that. He actually runs products. So it's better if I have him answer that.

A

Brian Morrison

Analyst, TD Securities, Inc.

Sure.

Q

Brian Hill

Founder, Chief Executive Officer & Chairman, Aritzia, Inc.

Yeah. I mean, we don't – we have – we just have sort of two or three buckets, we have like 15 buckets or 20 buckets of product. Some would fall into various categories. There is casual clothing, which probably isn't necessarily at leisure than we have denim and we actually have at leisure product and we have going out at night, but maybe not so sundress, something like that which isn't necessarily formal. So, we're pretty balanced right across the board and you can imagine things are being skewing a little bit more from a stay-at-home comfort perspective. And we've had obviously a lot of success with that product to the point where we found some inventory pressure running out on some of the products. And then some of the other products, some are going out at night and dressing to go to work and things like that is we've had less demand for that.

A

That said, I think what's important to recognize is that a lot of our product that we sell is test and react. And so we've had a lot of product that over the – that is in our product that is very test and react and therefore, we were not committed to any high inventory levels or any particular product than we'd be able to adjust. And as I mentioned earlier, we have less product than we think we have to move at the end of the season right now than we did at the exact same time last year. So, we think our inventory is in really, really great shape, and we're adjusting and making moves as quickly as we possibly can to reflect the demand of the certain types of product that we've been getting.

Brian Morrison

Analyst, TD Securities, Inc.

Okay. Thank you very much.

Q

Operator: This concludes the question-and-answer session. I would like to turn the conference back over to Helen Kelly for any closing remarks.

Helen Kelly

Vice President, Investor Relations, Aritzia, Inc.

Thank you, Anastasia. And thank you. Thanks again, everyone, for joining us this afternoon. Team and I will be available after the call to answer any questions you may have. We look forward to speaking with you again very soon. Thank you.

Operator: This concludes today's conference call. You may disconnect your lines. Thank you for participating and have a pleasant day.

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