

Hewlett Packard Enterprise

Hewlett Packard Enterprise Investor event
conference call

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CORPORATE PARTICIPANTS

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PRESENTATION

Operator

Hello. And welcome to the Hewlett Packard Enterprise Investor event conference call. My name is Cole and I'll be your conference moderator for today's call. At this time, all participants will be in a listen-only mode. We'll be facilitating a question-and-answer session toward the end of the conference.

Should you need assistance during the call, please signal conference specialists by pressing the "*" key followed by "0." And as a reminder, this conference is being recorded for replay purposes. I would now like to turn the call over to your host for today's call, Mr. Andrew Simanek, Vice President of Investor Relations. Please go ahead.

Andrew Simanek

Good morning. This is Andy Simanek, head of Investor Relations at Hewlett Packard Enterprise. I'd like to thank you for joining us today to discuss the announcement of HPE's intent to acquire Zerto. Joining me on today's call are Antonio Neri, HPE's President and Chief Executive Officer, Tarek Robbiati, HPE's Executive Vice President and Chief Financial Officer, and Tom Black, Senior Vice President and General Manager of HPE's Storage business. Antonio, Tarek, and Tom will make some opening remarks. And then, we'll open up the line for questions.

Before handing the call over to Antonio, let me remind you that this call is being webcast. A replay of the webcast will be made available shortly after the call for approximately one year. We posted the press release and the slide presentation accompanying today's announcement on our HPE Investor Relations webpage at investors.hpe.com. As always, elements of this presentation are forward looking and are based on our best view of the world and our businesses as we see them today.

For more detailed information, please see the disclaimers of the acquisition materials relating to forward-looking statements that involve risks, uncertainties, and assumptions. For discussion of some of these risks, uncertainties, and assumptions. Please refer to HPE's filings with the SEC, including its most recent Form 10-K and subsequent quarterly reports on Form 10-Q. HPE assumes no obligation and does not intend to update any such forward looking statements.

For financial information that is expressed on a non-GAAP basis, we have provided reconciliations to the comparable GAAP information on our website. Antonio, Tarek, and Tom will be referring to the slide presentation accompanying this announcement throughout the prepared remarks. As mentioned, the investor presentation can be found on our website and is embedded within the webcast player for this call. After the opening remarks, we will host a question-and-answer session where we will only be addressing today's announcement. With that, let me turn it over to Antonio.

Antonio Neri

Well, thanks, Andy. And good morning, everyone. Thank you for joining us today on such short notice. Today, I'm extremely excited to announce that HPE is expanding our HPE GreenLake Edge-To-Cloud Platform by signing a definitive agreement to acquire Zerto, an industry leading in cloud data management and protection services. This acquisition accelerates HPE Storage transformation to a cloud-native, software-defined data services business.

Zerto's industry leading disaster recovery software is proven with over 9,000 customers globally and over 350 managed service providers who power the Data Protection as-a-Service offering

with Zerto's software. Built on what we call a journal-based continuous data protection, or CDP technology, Zerto positions HPE to help customers protect virtualized cloud-native and Kubernetes application workloads, recover rapidly to a state in seconds prior to ransomware, cyber-attacks, and other disruptions, and mobilize that application data across hybrid and multi-cloud environments.

We know every organization today sees data as their most critical assets. But the complexity to manage data has never been higher. The threats to data has never been more severe. In addition, the need to turn data into insights has never been more important. Our data continues to grow exponentially from Edge to Clouds. Organizations need a new way to experience and unlock enterprise agility, empower innovators, and unleash the full potential of data. To address these critical issues, HPE Storage recently unveiled what we call Unified Data Operations, or DataOps, a vision that redefines the way organizations manage their data and infrastructure by eliminating the silos and complexity, while streamlining data operations across hybrid clouds.

We recently introduced HPE Data Service Cloud Console powered by HPE GreenLake to deliver on this vision with an expansive suite of cloud data services that automates and orchestrates data and infrastructure with a cloud experience wherever the data lives. And integral to this vision is a strategic business transformation of HPE Storage to cloud-native, software-defined data services, with storage and data management delivered as-a-Service. The first step towards this transformation was the introduction of HPE Alletra in May, a cloud-native data infrastructure management, managed natively through what we call the HPE Data Service Cloud Console, as a part of HPE GreenLake.

We are now taking another big step forward in achieving our vision with today's announcement. And to provide a little bit more details about what this technology does for customers and how we're going to integrate that in our vision, I would like now to pass it on to Tom Black, which is our Senior Vice President and General Manager for the Storage business unit. So, Tom, over to you.

Tom Black

Well, good morning. And thank you, Antonio. I really couldn't be more excited to be speaking with the group today and announcing this combination, merger, between Zerto and the HPE Storage team. I think it's really easiest if we look at slide six please, Andy. And we talked a bit about what is so profound about this technology, and review some highlights and, again, talk about the path forward.

So Zerto really is the market leader in what's called continuous data protection. What that means is, every server in our customer site is instrumented with their core technology to do basically small, say, five second checkpoints of what an application is writing to any data store. These checkpoints are then bundled up and moved to a secondary site. Could be a public cloud. It could be your secondary data center. It could be a colo.

But the most important thing is if you look at when a disaster hits, you can rewind literally to within seconds of when the last known good information was in every store. All of your VMs and data, all of your containers and your applications in that secondary site. So really, what that gives our customer is the fastest Recovery Point Objective for always-on applications. With Zerto technology, again, you have within seconds, you can snapshot--you can grab an entire view of a data center and your workloads, and then bring it up in short seconds or minutes in a secondary site.

While Disaster Recovery has always been critical for business continuity, as many customers look at their end-to-end strategy for IP, ransomware as a new and very serious threat in the market, as publicized by two very recent, large-scale hacks. It is top of mind, as I talked to CIOs over the last several weeks about those two hacks. It inevitably becomes a key topic of--of discussion.

And if you look at this technology, this is probably the market-leading solution at a technical level, and has proven to a large customer base to protect against ransomware. Because you can rewind to within seconds before when the attackers took your data, encrypted it, and are attempting to hold a customer hostage, it really--it really brings the value of that attack down to, again, short seconds, or basically down to worthless.

So in today's environment, ransomware and the Zerto technology, just an incredibly powerful combination. With Zerto, you can create a common D.R. and common security strategy across really any cloud. You, again--you can move from a VMware environment on your premise to a VMware environment in the secondary colocation. You can move from VMware on your premise to an Amazon or Azure data recovery. You can do cross--cross cloud data protection and recovery. So very, very powerful technology that is really built for today's hybrid IT and multi-cloud world.

Extended use cases for the technology are really around, you know, there's some--some dev and test use cases, data migration, data mobility, going from, say, a secondary data center to a primary, and then a colo facility. All of these--these options, all of this very powerful technology, top of mind and relevant for CIOs today in a dynamic world where business continuity and security have become top of mind.

If we look at slide 7, what we've see is Zerto was founded in 2009. It's headquartered in Herzlaya, Israel. We have approximately 500 employees joining my team and serve over 9,000 customers. They have a diverse offering, viewed as a leader in the Magic Quadrant. Really, if you look, they're--they're a managed service provider business that underpin nearly every large MSP's business as well as direct to enterprise. We will cover the financial section a little bit later.

But, again, over 350 customers from the managed service providers segment use Zerto as the basis for their business. We're very, very proud of the team and their accomplishments, recognized by Gartner in its Peer Insights as the Customer's Choice delegation. You know, and as we went through the process in having this--you know, I got the chance to meet this wonderfully talented team. As we had a chance to meet their customers, really, they have a reputation for very high quality, for a delightful experience with customers, which is a brilliant fit to the culture and tone and drive here at Hewlett Packard Enterprise, and one that at HPE Storage we embrace fully.

And with that, let me take a moment to talk about how Zerto will integrate into the overall Storage business and expand our Cloud Data services that we offer currently through the Data Services Cloud Console that was announced and launched on May 4th.

So if we can please move to slide eight, Andy. You can think about our console, kind of, roughly, if you will, as a bit of a three-layer cake. On the bottom is all of our cloud native infrastructure. Today--or May 4th, we announced the Alletra 9000, the Alletra 6000, as really, kind of, that mission critical and general purpose, new cloud-native brand. And you'll see that brand and that cloud native attribute roll through the rest of the portfolio as we move forward.

Also recently announced was our--all your, manage your entire data estate from anywhere in the world with--with suite management. The idea that you can disassociate, insert to disintermediate the knowledge of a specific storage system to what a workload means. So that intent-based provisioning cycle, giving you an application-centric and workload-centric view, particularly features about security, audit, policy management. And then of course, APIs where our partners and our customers can bring value-added workflows or applications and practices on top of our--our console.

And again, as we discussed at the launch, we are bringing out an entire suite of data management, data lifecycle management, data and storage analytic services on top of the console. And what I'm really very excited about is, as we integrate Zerto into the top layer of our cloud data services, we get market leading and a significant acceleration of our strategy around two very core services that are top of mind for customers as I've discussed earlier in my--my commentary. This--this technology and this team joins, really, our family after, really, the right time. Extremely talented group of folks around the world.

I particularly want to acknowledge the--the R&D team at the center of the company in Israel. As many people know, Israel is a thriving hotbed, kind of the Silicon Valley, several time zones away. In terms of the talent, the ecosystem has, really, the power and the meaningful innovation that comes out of this region. I couldn't be happier to announce Zerto and, really, the Israeli opening of a center of excellence for HPE Storage, as we--as we move to drive towards the close of this acquisition and work together moving forward as one team. So I think with that, Tarek, if I could please turn it over to you, sir, and take you through some of the transaction--take us through some of the details.

Tarek Robbiati

Thank you, Tom. Good morning, everybody. I certainly share Antonio's and Tom's excitement for this transaction. And we look forward to the benefits of extending our storage Cloud Data services with Zerto's platform. If we turn to slide nine, let me provide you with a little bit more details regarding the transaction. Under the terms of the definitive agreement, we will acquire Zerto for \$374 million in all-cash transaction, which will be financed through available cash on our balance sheet.

As stated before, we remain committed to maintaining our Investment-Grade credit rating. And we obviously do not expect this transaction to impact our rating. This transaction will result in an enhanced financial profile for our Storage and as-a-Service business. We expect the combination to drive significant revenue opportunities at software gross margins, which are accretive to this Storage business profile.

Zerto generated approximately \$130 million of revenues last year. And approximately one-third of their overall revenue is additive to HPE's as-a-Service annualized revenue run rate, ARR metric. Zerto's revenue is very high quality with strong gross retention rates above 90% and no pass-through hardware revenue. We are--also expect the transaction to be marginally dilutive in fiscal year '22 and accretive to both non-GAAP operating profit and earnings per share in fiscal year '23.

I would note, annual stock-based compensation related to this transaction is quite small. Finally, we expect the transaction to close by the fourth quarter of HPE's fiscal year 2021. And it is subject to regulatory approvals and other customary closing conditions. Now with that, let me hand back the call to Antonio for closing comments.

Antonio Neri

Yeah. Thanks, Tarek. And thank you, Tom. I hope you get the sense we are incredibly excited about this new addition. We have been very consistent on our strategy to pursue assets that bring unique intellectual property and talent that accelerates our vision to become the Edge-to-Cloud Platform company. And more--and more of that, obviously, is in the software space and in the data space. You know, last week, we hosted HPE Discover where I said we are entering the age of insights where data, obviously, is the most precious asset that customers have.

And I believe in the near term, I think data will be an asset that will be recognized in the balance sheet of companies. But protecting that data is essential. Obviously, we live in a very unique world that is--is creating some interesting challenges. This conversation about data protection and IP protection is becoming an incredible, important topic for boards and other committees. And I believe Zerto brings a unique set of intellectual property and technologies that actually not only accelerate our vision to become an Edge-to-Cloud Platform, but also transform the Storage business into a software business with higher margins.

So very excited about today. We are looking forward to complete this transaction in Q4 and--and obviously leverage our vast go-to market as we continue to make great progress on our--on our pivot as a company to drive the growth that Tarek just described. So with that, I'm going to give it back to Andy, because obviously we have few minutes here to answer any questions you may have.

Andrew Simanek

Great. Thanks, Tarek, Antonio, and Tom. Operator, can we take the first question please?

QUESTION AND ANSWER**Operator**

Certainly. And we will now begin the question-and-answer session. To ask a question, you may press "*" then "1" on your touch tone phone. If you're using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question please press "*" then "2." We also request that you ask one question only. Our first question today will come from Simon Leopold was Raymond James. Please go ahead.

Simon Leopold

Great. Thank you for--for doing this call and running through this. Appreciate it. Little bit to digest here. I wanted to see if you could help me unpack the revenue contribution a little bit more. And that you--you've indicated one-third of revenue is additive to the as-a-Service. Is it safe to assume that the bulk of the other two-thirds would be software subscriptions and therefore also recurring? And how does this addition affect your overall targets for the ARR? You've talked about GreenLake getting to 5% of revenue. Just help us understand where this all fits in, and the other two-thirds of the Zerto revenue, how you characterize it. Thank you.

Tarek Robbiati

Sure, I kind of--

Antonio Neri

Yeah. Yeah. Please go ahead, Tarek.

Tarek Robbiati

So, Simon, thanks for asking the question. So Zerto's revenue total about \$130 million. The vast

majority of that revenue is software license, that is the two-thirds, which is recurrent by way of any software license that is getting renewed. The one-third remaining is a SaaS type of revenue, which is subscription based. And this is what would accrue to ARR. In our ARR definition, we do not include the licensed revenue.

But as this business becomes more and more SaaS driven and integrated into GreenLake, it will accelerate our overall ARR generation. So on the ARR, as a reminder for everybody, we expect our ARR to grow between 30% to 40% per year. At the end of Q3, we were at \$678 million. And we expect that growth of 30% to 40% to be an annual--compounded annual growth rate over the next three years.

Operator

And our next question will come from... apologies--

Andrew Simanek

No, no, please go ahead with the next question. Thank you.

Operator

Okay. Our next question will come from Wamsi Mohan with Bank of America Merrill Lynch. Please go ahead.

Wamsi Mohan

Yes. Thank you. Congrats on the deal. I was wondering if you could just talk about the technology that allows for the more fine-grained, let's call it, snapshots. And what are some of the trade-offs or costs associated with that when a customer thinks about, you know, getting on this more finer grained recovery path? And, Tarek, if you--if I could, you said it was marginally dilutive in fiscal '22. Is it, like, less than \$0.05? If you could just clarify in any impact to--to free cash flow. Thank you.

Antonio Neri

So, Tom, you want to take the first part on the technology side?

Tom Black

Yes, sir. And thank you for the question. So there's two--there's two, kind of, major technology techniques used to establish what's called a Recovery Point Objective, or RPO, that affects your--your time to recovery. The bulk of the vendors in the market, they kind of key entered through Backup and Recovery at what--as you call it, a snapshot-based technology. We do snapshots, obviously, in our arrays today.

But these typically operate on a quantum of minutes or hours as you--as you look at where you can acquire the data, take a view of it, and again, save it off as a--as a checkpoint if you will. Continuous Data Protection, which is what Zerto has mastered and leads the market, is a much more difficult--much more difficult technological implementation. Because it--it means you basically have to capture every byte, if you will, coming out of an application on a server, and--and then save it for, as a recovery point, for later in time.

The combination of the instrumentation of the server, or journal-based technology, gives them an extremely effective, from a time quantum perspective as well as a cost perspective, in being able to do these very high-frequency checkpoints. Now, if you look at how we bring this to market, and often how customers deploy, and as I talk to my larger partners, typically what a customer will do is, they would prefer to have a Zerto CDP technology for some number of days

for very active, always-on application protection, Ransomware protection, as I mentioned during my earlier comments. And then as you move out into the timeframe of a week or two weeks, people will then start to take a snapshot, really, of those--of the journal, and then back that up for deeper archive for a restore.

So it's really about customers making a choice as to using the more advanced CDP for always-on DR for Ransomware. And then, at some time in their--in their own policy, in their own compliance environment, flipping over the snapshot, which is what most of the Backup and Recovery vendors do today at Zerto for--for deeper, less expensive archives and cold storage moving forward in time. And I think the second part of the question that would go, Tarek, to you, sir.

Antonio Neri

Yeah. Before we got to that Tarek question, I want to say the one important part also to recognize here is that with this acquisition, we are actually extending our TAM opportunity, because when you look at this type of technology, and obviously in the context of what we see today, ransomware and cyber-attacks, the market is actually growing very, very rapidly. You know, think about it around \$8 billion dollar market size now grow into potentially \$15 billion in the next three years.

So for us it's not only an opportunity to provide a significantly differentiated technology to protect from these type of attacks. To do these type of technologies incredibly hard. And then, we put this in our turbo charged HPE GreenLake Edge-To-Cloud Platform. And at the same time, not only we expand the TAM, also we transform the Storage business with higher margins. So that's why this combination is--is a multiple trifecta, as they call it, of benefits for the company, and honestly for the customers' value proposition. So, Tarek, you want to take the part to the financials that was asked?

Tarek Robbiati

Sure. Wamsi asked about the dilution for '22, whether it was sub \$0.05 per share and the impact on free cash flow. So, Wamsi, the answer is fairly straightforward. It's marginally dilutive as one to two pennies, and nothing more. We may not even see that. And it has zero impact on free cash flow in fiscal year '22.

Andrew Simanek

Great. Thanks. Thanks, Wamsi, for the question. Operator, can we go to the next one, please?

Operator

And our next question will come from Katy Huberty with Morgan Stanley. Please go ahead.

Katy Huberty

Thank you. Congrats on the deal. Three times revenue multiple for a cloud-based software business is incredibly attractive for HPE. Why do you think you were able to pick this business up at such a low valuation? And then can you comment on Zerto's forecasted growth rate relative to the 19%? Market CAGR that you highlighted?

Antonio Robbiati

Yeah. I'll maybe start. And then Tarek and Tom can chime in. I think there were a couple of factors. Number one, the fact that Zerto resonated our vision from Edge-To-Cloud. You know, as I said, multiple times, Katy, data lives everywhere. But to be able to offer these as a part of a platform versus just a standalone offering was for them very attractive to accelerate their vision.

Second, is the fact that, in order to grow, you have to continue to invest in go-to market. And obviously, we have--one of the crown jewels in the company is our go-to market, particularly with the channel partners.

And so as we integrate this offer in our--in our overall solution, it exposes them to markets that, honestly, they couldn't grow because the lack of potential investment they needed to make. And then, so I think, as always, right, when you do an acquisition has to have meetings of the minds. And Tom and the current CEO of Zerto, they totally aligned on what their vision looks like. And I totally agree that this is an opportunity to accelerate that growth in a unique time in that we live today.

So it's a combination of those factors that ultimately worked, I guess, in our favor, but also in the favor of Zerto because now they can focus on accelerating that innovation while we take our go-to market and open up for them in an integrated solution. Now, Tom and Talek, is there anything you want to add to that?

Tom Black

Sure. I'll just add a brief comment. You know, it was--it was very apparent in our early meetings with Ziv and Oded Kedem, the founders of Zerto, we, you know, the--the chemistry is there, I think the cultural alignment on how we run an organization and our value system, the--this the absolute focus on innovation and the customer. And then, I think, as I--as I have a chance to explain to them, and his extended leadership team, with our overall Cloud Services and data services transformation and with the Data Service Cloud Console that we just launched, it became very apparent to the organization that the Zerto team has been on for a number of years and doing very well at a technical level and then at a go-to market level. It was a really good match to Hewlett Packard Enterprise and the way we're driving the Storage business. So the technology integrating with our cloud strategy, and then as Antonio mentioned, the opportunity to take that technology at scale with our cloud platform and drive it through Hewlett Packard Enterprise go-to market machine, both our direct sales force and our vast, vast global partner ecosystem, really, I think, helped us both come together and realize that this was a one plus one equals three. And that's what got us here this morning.

Tarek Robbiati

Yeah. Katy, I would simply add on the growth profile of Zerto, overall, Zerto grows low-single digits. And they are transitioning to SaaS. Their MSP, managed service provider revenue, which is a third, and which will contribute to our ARR, is growing at 15% per year. And as they transition more and more on their license revenue to SaaS, you can see an acceleration potential there. But for that potential to be realized, as Antonio and--said and Tom said, you really need two things. You need that go-to market that is giving you the access to large amounts of customers, and we have that, and also a platform to be able to connect that to accelerate the SaaS revenue. And we do have that now as well.

Antonio Robbiati

I think the other part here, Katy, that's why I'm excited, is the fact that if you saw on slide eight that Tom showed, this is another cloud-native service that will show as a part of the HPE GreenLake console. And when we land that Edge-To-Cloud platform with GreenLake, we actually grab new workloads. And this is another workload, Disaster Recovery. And the timing of this is kind of interesting because of what we see in the market. So I feel GreenLake and our go-to market will be a double whammy acceleration of what they had done to this time.

Andrew Simanek

Great. Thanks for the question. Operator, can we go to the next one, please?

Operator

And our next question will come from Aaron Rakers with Wells Fargo. Please go ahead.

Aaron Rakers

Yeah. Thanks. And also, congratulations on the--on the transaction. I guess some--some of this has been answered in prior--prior comments. But I'm curious as you kind of evaluated the landscape and looking at an acquisition like this to fit into the Data Protection of role in HPE's portfolio, how--how do you consider--how do you think about Zerto from a competitive landscape perspective? I'm thinking about how does this company compete against the likes of Commvault or Rubrik or Cohesity? Who would you most compare it to?

Antonio Robbiati

Great question. And actually, I would like Tom to answer that question. Because, you see, the Storage business is a fairly complicated, segmented market. You have primary storage. You have secondary storage. And in primary storage, obviously, we can talk about the traditional way to deploy appliances. And then you have multiple type of protocols, file, block and object. Or you have the software-defined or hyper-converged. And then, with your secondary storage, obviously, you have Backup and Recovery, and you have Disaster Recovery.

And I can tell you in the Disaster Recovery, there is not many people at all. But maybe, Tom, you want to comment about this. Because this was exactly one of the things we looked at. And we felt very good about this acquisition because of the space that creates for us, versus the competitors you've named. So, Tom?

Tom Black

Yes. Thank you. So if you look at, kind of, the Data Protection as-a-Service space, you have a host of vendors like those you mentioned, most of which I believe were all valued partners of HPE that really started in Backup and Recovery. They started, per my previous comments, more in the snapshot-based arena with regards to how quickly, and at what frequency, you can take a--a--a, basically, snap of the data and then restore it somewhere in the event of a failure.

To a large degree, many of the vendors that have started in Backup and Recovery are trying to move towards Disaster Recovery, which has a much higher Recovery Point Objective and a much lower recovery time to restore--or Restore Objective in the market. Zerto started, instead of in Backup and Recovery and snapshot-based, they started, they went to the very most difficult square to start with some number of years ago. And this team impact, I believe, is the undisputed worldwide leader in that most difficult technical problem, starting with their CDP technology.

And as you--you may have seen them talk about, they're--they're, kind of, heading more towards backup, which is a perfect integration with--with our own data services strategy here at HPE. So again, deep respect to some of the companies you mentioned. But we chose first to go after the--the premier team and tech with the hardest technology problem and then move towards backup versus going--starting with backup and then trying to solve the most difficult technical problem as a secondary effort. So thank you for the question.

Andrew Simanek

Great. Thanks, Aaron. Unfortunately, we're--we're past time. So that'll have to be our last question. But appreciate, you know, everyone for hopping on the call on such short notice.

Antonio, maybe I'll turn it over to you for any final comments.

CONCLUSION

Antonio Robbiati

Yeah. Well, first of all, thank you for--for attending this call in such short notice. Again, very excited about this acquisition. Remember, a week ago, we also announced the acquisition of Determined AI. And both of them are the core of what we see which is about data, you know, whether it is extracting insights from the data faster or protecting data, you know, in a--in a scalable and differentiated way.

And these two acquisitions both support our strategy to become an Edge-To-Cloud Platform where data is at the core. And so, again, I hope you'll recognize that our moves are consistent to what we have said now for a long period of time. And financially, you know, this is--this is a great addition to our--in our portfolio. But it makes us a more Cloud company in everything we do.

And--and that's why it's so exciting. And everything we do caters to one thing, which is HPE GreenLake. Which is getting significant recognition in the market interaction, and at the same time, actually propels our storage business to become a cloud software-defined portfolio. And so, thank you for your time today. And hope to catch up to you soon--with you soon.

Andrew Simanek

Great. Thanks, everyone. Operator, we can go ahead and close out the call.

Operator

Ladies and gentlemen, this concludes our call for today. Thank you for attending. And you may now disconnect your lines at this time.