Perion

Second Quarter 2020 Earnings Conference Call

August 05, 2020

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John Nobile, *Taglich Brothers*

Eric Martinuzzi, *Lake Street Capital Markets*

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to Perion's Second Quarter and Annual 2020 Earnings Conference Call.

For information, today's conference is being recorded. The press release detailing the financial results is available on the Company's website at perion.com. Before we begin, I'd like to read the public Safe Harbor statement.

Today's discussion will be—will include forward-looking statements. These statements reflect the Company's current views with respect to the future events. These forward-looking statements involve known and unknown risks, uncertainties and other factors, including those discussed under the heading Risk Factors and elsewhere in the Company's annual reports on Form 20-F that may cause actual results, performance or achievements to be materially different and any future results, performances or achievements anticipated or implied by these forward-looking statements. The Company does not undertake to update any forward-looking statements to reflect future events or circumstances.

As in prior quarters, the results reported today will be analyzed both on a GAAP and non-GAAP basis. While mentioning EBITDA, we'll be referring to the Adjusted EBITDA. We have provided a detailed reconciliation of non-GAAP measures to the comparable GAAP measures in our earnings release, which is available on our website and has also been filed on Form 6-K.

Hosting the call today are Doron Gerstel, Perion Chief Executive Officer, and Maoz Sigron, Perion's Chief Financial Officer.

I'd now like to turn the call over to Doron Gerstel. Please go ahead, sir.

Doron Gerstel

Thank you, and good morning.

As we shared on our last quarterly call, the impact of COVID-19 has been broadly evident across the advertising industry in the first half of 2020, with the most severe impact experienced in the second quarter. According to a recent eMarketer report, digital ad spending is expected to decline by approximately $20 billion, representing a steep 20% drop from 2019. This estimate, in its essence, point to a second half rebound, because depending on how you analyze the data and which statistics you follow, the decline during the second quarter was as much as 45%. Despite this massive and material industry-wide decline in spending, Perion delivered consolidated year-over-year revenue growth in the first half and the decline in our second quarter revenue was approximately 5%, far lower than the steep double-digit decline experienced across the broader industry. We are achieving this from a position of financial strength while advancing our fundamental strategy of driving additional top line growth and profitability through innovation and accretive M&A without raising additional capital or risking our balance sheet. Our strategic diversification across the main pillars of the digital media ecosystem served us well as did our ability to cut costs quickly and surgically. Our leadership and management have been through a turnaround plan that required a cleared-eye assessment of the situation and willingness to cut under stress.

The culture and muscle memory enabled us to get through this devastating second quarter far better than most. Despite the more 15% industry-wide decline in paid search advertising and significantly reduced cost per click rates in the first half of 2020, our revenue grew by 8% year-to-date as we continue to grow the number of monetizable search queries we delivered to Microsoft Bing. Simply put, we are outperforming our peers and mitigating near-term pressure that lower advertising budget. We are leveraging our technology platform and are identifying new publisher who have been hurt by the crisis and are seeking new sources of revenue.

In advertising, reduction in ad spending across all sector, travel and automobile, in particular, in the rate of 25% to 35% negatively impacted our advertising business, but to a much smaller extent due to the acquisition of Content IQ.

Looking forward, I'm encouraged by business indicators and market trends in the early part of the third quarter that provide us with improved visibility and increasing confidence that the worst of COVID-19 impact is behind us, so much so that we have made the decision to provide the revenue and Adjusted EBITDA outlook for the second half of the year.

While the first half of the year was strong, there is no doubt the second quarter was challenging. The financial impact of COVID-19 and stay-at-home orders had significant impact on consumer behavior and marketing activity with few exceptions across client industries and geographies. In this regard, management decision to execute $10 million annual cost saving plan happened to be right move.

I'd like to move to some highly significant business achievements made during the second quarter. We are very pleased with our deep, lasting and expanding partnership with Microsoft. The growing number of high-quality and monetizable searches is a fundamental to the strength of this relationship. More specifically, over the last three months, we enhanced our partnership with Microsoft to cover more products, business models and additional geographies. We partnered with Microsoft MSN to distribute MSN News in 140 countries on a rev share basis. It is a unique opportunity to provide our publisher high-quality content from a premium news outlet in 140 countries. This will not only drive new revenue stream for online publisher but would also keep their visitors engaged.

Furthermore, Perion will start distributing product ads in 14 countries, which we estimate will boost CTR and RPM. We are also happy to announce that Microsoft improved—approved Privado for mobile, and it is now being tested with the large mobile operator in France as privacy was and remains a hot issue in Europe.

Content IQ integration has gone smoothly, and it is now completed. We are very pleased with the CIQ performance in the second quarter and our confidence in the business and its leadership is behind our recent acquisition of Pub Ocean, which I will get to shortly. As the digital advertising ecosystem is being reshaped, without cookies, publisher will have to find new ways to measure and track user engagement. That couldn't be better for CIQ because it dramatically increases the value of what they do, which is create invaluable first-party data for brands through engaging content and contextually relevant advertising, keeping the consumer on brand-safe sites for up to seven minutes, an extraordinary long time in today's ADHD consumer world.

We are currently working on developing the infrastructure to enhance the integration of CodeFuel's intense signals into the Content IQ and Pub Ocean platform, and also integrating Undertone's high-impact ad units. This is an example of the cross-platform integration and the synergy within the current portfolio that will increasingly occupy our strategic and technology focus.

Moving to our recent acquisition, Pub Ocean. Last month and subsequent to the end of the second quarter, we acquired this innovative publisher technology platform. It's part of our pub-tech strategy. We are impressed by their recommendation engine, called Mission, and real-time revenue analytics technology, called LiveYield, which are hand in glove fit with CIQ. This accretive and synergistic acquisition offers significant and immediate synergies to CIQ. With Mission and LiveYield technology, CIQ programmatic bidding algorithm can better optimize media buying campaign by using higher quality data. Improved content recommendation engine will open the door to additional audience segment and further optimizing consumer session. In parallel, Content IQ superior on-page monetization capabilities are instantly synergetic to Pub Ocean yield and growth. Pub Ocean is expected to generate an incremental $25 million in revenue and $5 million in Adjusted EBITDA over the next 12 months. We were able to make this acquisition from a position of strength without raising additional capital or adding leverage to our balance sheet.

Perion's social brand advertising SaaS platform, MakeMeReach, has expanded its partnership with Havas Media Group. Havas will leverage Perion's platform across its global network to deliver meaningful social campaign for clients and their consumer across their 140 offices around the world. MMR SaaS platform has now completed over 50% growth year-over-year in ACV.

In our Undertone business, a bright spot was video, which was up 115% in the first half, driven by budget achieved from linear TV and other digital formats and very high and increasing time spent with digital video, largely connected TV.

With that, I would like to turn the call over to Maoz to review the financial results for the second quarter. Maoz?

Maoz Sigron

Thank you, Doron. Amid COVID-19, during the second quarter of 2020, we completed our cost-saving plan and experienced better-than-expected business results, both in our advertising and search business units. Based on current visibility, we believe that the worst is behind us, which enable us to provide revenue and Adjusted EBITDA outlook for the second half of the year. We believe that the trajectory of the recovery will be gradual and uneven.

At the beginning of the third quarter, we completed the acquisition of Pub Ocean, further bolstering our advertising business unit. Similarly to CIQ, this acquisition includes a substantial earn-out component, thanks to various financial metrics over the next two years.

Turning to the results. During the second quarter of 2020, revenues decreased by 5% from $63.6 million in the second quarter of 2019 to $60.3 million, composed of $18.7 million from advertising and $41.7 million from search and other revenues. This decrease was primarily a result of a 12% decline in advertising revenue, mainly due to COVID-19 impact on ad spend across the industry. The negative impact was partially offset by the acquisition of CIQ on January 14, 2020.

Sales and other revenue decreased by 1% as a result of lower paid sales rate due to COVID-19, offset by growing number of monetized search query. Sales and other revenue represented 69% of the second quarter of 2020 revenues, with advertising contributing 31%.

Customer acquisition cost in media buy in the second quarter of 2020 were $36.8 million or 61% of revenue compared to $33.2 million or 52% of revenues in the second quarter of 2019. The increase, as a percentage of revenue, is primarily due to the acquisition of CIQ and the product—and product mix.

Net loss for the second quarter of 2020 was $2.2 million or $0.08 per diluted share compared to net income of $2.9 million or $0.11 per diluted share in the second quarter of 2019.

Perion's non-GAAP net income in the second quarter of 2020 was $1.9 million or $0.07 per diluted share compared to $5 million—to $4.5 million or $0.17 per diluted share in the second quarter of 2019. Adjusted EBITDA in the second quarter of 2020 was $2.5 million compared to $7.4 million in the second quarter of 2019.

Cash provided from operations in the second quarter of 2020 was $200,000, inclusive of approximately $2 million decrease due to working capital needs in connection with the acquisition of CIQ compared to $8.4 million in the second quarter of 2019. As of June 30, 2020, we had cash, cash equivalents and short-term bank deposits of $47.9 million compared to $61.6 million as of December 31, 2019.

Total debt as of June 30, 2020, was $12.5 million compared to $16.7 million as of December 31, 2019. During the second quarter, we paid $2.1 million of total debt as part of our payment schedule.

I will now turn the call back to Doron for closing statements.

Doron Gerstel

While the—thank you, Maoz. While the pandemic impacted our second quarter results at levels much lower than the overall industry, it has not interrupted the implementation of our strategy to drive additional top line growth and profitability through accretive M&A. The accretive acquisition of Pub Ocean, along with rapid cost containment initiatives and successful integration of Content IQ are supporting our growth strategy and enable us to remain highly profitable.

Based on business indicators and improving trends that we are experiencing during the third quarter, we believe that the worst of the COVID-19 disruption is behind us, and while we believe the trajectory of the recovery will be gradual and uneven, we're increasingly confident in our visibility. Based on this, we are providing guidance for the second half of 2020. We expect to generate revenue between $150 million to $160 million. We expect to generate $11 million to $13 million in Adjusted EBITDA. We are continuing to leverage our diversification strategy to capitalize on increased volatility in the market. We are also building towards a more synergistic Perion, which will simplify and streamline the effectiveness of our go-to-market effort and create further shareholder value.

I would like to end our earnings call by thanking the entire Perion team for their resiliency and agility this quarter through very challenging conditions. I'm proud of how they step up and didn't miss a beat, serving current clients and driving new revenue.

Operator, you can now open the call for questions.

Operator

Thank you very much, sir. Ladies and gentlemen, if you ask a audio question, please press star, one on your telephone keypad. Also please ensure that your mute function is activated to reach equipment. So once again ladies and gentlemen, please press star, one.

Today's first question is coming from Mr. Eric Martinuzzi, calling in from Lake Street. Please go ahead. Your line is open.

Eric Martinuzzi

Congratulations on the second quarter results. I wanted to ask you a question on your two acquisitions and kind of just if you could compare and contrast Pub Ocean versus CIQ? And then I have a follow-up. I understand they're both publisher-facing technologies, but just a layer deeper on those two, please?

Doron Gerstel

Yes, definitely. So, I think we described in brief the use case, but they are quite complementary, and what Content IQ was very much missing is what's on in the industry is content recommendation, content recommendation capability. Content IQ is very much driving its traffic from Facebook through their buying capability in Facebook. And there is a whole other way of doing it through content recommendation. That was very much on the plans of Content IQ to develop. Between the decision of building it or buying it, we decided to go and search for companies that have this capability that not just can provide this capability and very much shorten the time to market, but also be accretive. And so together with the buying system of Content IQ and the buying system of Pub Ocean, that basically cover the entire universe that we have the plan (phon).

Eric Martinuzzi

With Pub Ocean, I understand they have some own websites and that they also provide content recommendation on client sites. What percent of Pub Ocean revenue is monetized via own sites versus client sites?

Doron Gerstel

The majority is on their own site. It's like 80-20.

Eric Martinuzzi

Expected to persist? Or is that more things to more like a 50-50 over time?

Doron Gerstel

So, we're definitely looking to expand our capability to other sites, and at this time, what we are doing, we are consolidating the two systems. Content IQ already started with this effort, and there are two very large sites. One of them is Newsweek and the other one is AbonAir (phon), which we are providing this capability. Keep in mind, that it must be—use the—our infrastructure vis-à-vis the content that the CMS, content management system, that's the only way for us to ensure the five to seven minutes time or what we call the session time. So, the partnership is that those two sites are providing us valuable content to what we call the mini site that we are operating and basically using our optimization capability. That has to do with targeting the right audience, ability to control the layout and the content, and provide the right ad unit, all in all, in order to optimize what we call profit per session, even though it's running on domain, which is outside of our own. Does that make sense?

Eric Martinuzzi

Yes. I had a follow-up question with search business, very strong there in the first six months of the year being up 8%. Obviously, Q2 was down 1% but sort of to-be-expected, the contraction there and certainly being down only single digits relative, substantial outperformer. Just curious to know where we are on that relationship with Microsoft Bing. I know you've talked in the past about having it renewed around the October timeframe. What can you tell us about the renewal of that relationship?

Doron Gerstel

I think that the—first and foremost, the revenue in the six months, it was very much driven also by new product that we launch, I think that we are very happy about strengthening our partnership. This is the MSN News that we are feeding to 140 countries. It fits the product ad. And I must say that Bing is very, very happy with the experiment that we are doing with a large operator in France. It gives them presence on mobile, which they're looking at a very strategic. Those efforts are very much in line with their expectation. As I mentioned, strengthening our partnership, and I'm very much expecting that we will renew the agreement on October, as I said in previous calls, and the steps that—the efforts, the achievements that we're doing in the second quarter is definitely in line with this plan.

Eric Martinuzzi

I'll leave it there. Thank you for the questions and the strong quarter and the guidance.

Doron Gerstel

Thank you.

Operator

Now, we'll go to Chris McGinnis, calling in from Sidoti & Company. Please go ahead. Your line is open, sir.

Christopher McGinnis

Good morning. Thanks for taking my questions. Nice quarter.

I was just wondering if you could dig in a little bit more in terms of the trends you're seeing on the ad side, performed a little bit better than I was expecting. Is there any markets that are coming back (inaudible)? Can you just provide a little bit more color around what you're seeing there? Thanks.

Doron Gerstel

It's very difficult to hear you. If I got it right, you are asking us to elaborate more on the advertising business.

Christopher McGinnis

Yes, it was. Yes. Is that better?

Doron Gerstel

Okay. Yes, yes. Now, it's much better. I think that definitely, from the advertising business, as I mentioned, due to the fact that travel and automobile are responsible for good 15% to 20% of our revenue, you would expect that—well, others maybe increase their spend, in some cases, due to COVID it's not that compensate the loss of these vertical. And that's definitely something which happened in the second quarter.

Our indicators right now, and as you can imagine, based on the clients that we're working with, and those are, let's say, global 1,000 customers, they already placed their campaign for the third quarter. That's very much the optimism and the indicators that we're getting from, which we see it as quite a change from what happened in the second quarter.

Actually, it started very much on March already, where they were very much on the fence. And so, we see them coming back, we see them spending more money, we see them engaged with more units and it's not just a display. It's also the video. It's also the CTV units that we are now offering. So, all in all, I think that this is a very, very good indicator for us that gives us the visibility for H2, especially on the advertising business.

Christopher McGinnis

Okay. No, I appreciate that. That was exactly what I looked for. Just following the Pub Ocean acquisition, is there anything else you feel like you need to add to strengthen the platform and the offer? Thanks.

Doron Gerstel

No. I think that we are very happy with the technology that they have. I think that we are now—Pub Ocean was privately held Company and Pub Ocean was very much limited with their ability to scale, even though we're very happy with their projection in the next 12 months, which is—we very much stated. The $25 million and the—$25 million in revenue and $5 million in EBITDA. But I think that the capability is—their ability to scale is, we didn't mention it, but we definitely see a great opportunity there. It require us to inject more working capital. It require to definitely add more people, more on the data science, as we see it, but I think that we knew it because our capability is not what they have, and we are very much getting here the core competence that we didn't see, and probably it will take us around two to three years to develop. So, it was a very wise decision.

The other element, which I think we put a lot of emphasis on doing our diligence is the Company, their management capability, the culture fit that since we are expecting them to contribute, as I mentioned, from their financial from day one.

Christopher McGinnis

Okay, appreciate that. Good luck in Q3. Thanks.

Doron Gerstel

Thank you.

Operator

Thanks so much sir. Today's next question is coming from Derek Bobbe, coming in as a Private Investor. Please ask your question. Your line is open.

Derek Bobbe

Thank you very much. Good afternoon. Congratulations on showing resilience during a very challenging market.

I apologize if any of these questions are done. The system kicked me off at the beginning of Q&A. So, I missed the first couple of questions. So just I mean—so join in—I'll listen to replay.

Curious, you did some really great work on (inaudible), like you said, demonstrating growth in the first half despite a very challenging environment, despite downturns in both Microsoft and Google. How did you manage to show this degree of reliance in search despite such a difficult environment?

Doron Gerstel

Yes. I think that there are two factors, and the two factors is very much has to do with the different products that we have. The different product allows us here and especially the new product that we launched, as you can imagine, those are—that are coming to—is being installed in, let's say, mature large network of publisher that, for instance, if this is the MSN News, it's something which we have the platform to roll out easily. That’s too also from the product adds that we will add. All those things that their time to market is very, very, very short, allows us, once it's being—cross the gate of Bing—take us—it's matter of days till we're able to see a huge scale on our publisher. And that’s, I think, a great platform onboarding technology that we have that allows us to take new product off the gate really fast and immediately see the contribution to the revenue.

Derek Bobbe

That's helpful. And can you talk a little bit more about industry trends, CPM trends, in particular, starting in mid-March when shelter in place really hit and then through present?

Doron Gerstel

Yes. Yes. So, I think that it's—the CPM trend is definitely something that hit us hard. It hit us hard because as you can—as you know, we are selling high-impact or rich media ad units as the industry described it, and rich media ad unit by nature, are way higher CPM than standard units. To some point, we're talking about $15 to $17 CPM versus you can find $2, $3 of banner. And in this situation, advertisers when they reduce their budget, the first thing is that by reducing the budget, they don't want to reduce the number of impression. And, in order to accommodate both while you reduce budget, but you want to keep the number of impression, you're going from a high impact, rich media ad units, to lower cost ad units and a lower CPM ad unit ad, which put those luxury, even though giving way better return on ad spend, a bit on the side. I'm talking about from the advertiser portfolio standpoint, and we definitely hit it.

One of the indicators that we're looking at we basically see how now large advertisers are putting more and more budget towards those high CPM units that we are selling. And then, we are very much encouraging about it. But that was mainly—other than the fact that we're a few vertical, as I mentioned, that's travel and automobile that completely stopped their advertising budget. But the others were very much when I'm saying on the fence, they were very much allocate its budget differently and very much towards low end of units, which is something that hurts us.

Derek Bobbe

Great. Appreciate the color there. And then just thinking about the acquisition, the recent acquisitions of Content IQ and Pub Ocean, curious what Perion looks like one to two years out, once you've had a chance to integrate everything. And then are you anticipating additional acquisitions as well?

Doron Gerstel

Yes. So at this point, we definitely—we are really—even though we are happy after six months, we finished the acquisition of Content IQ January 14. I must say that even though we are happy, the postmerger integration efforts is very much still on, and we are looking about the second phase of it, which is very much integrated it with other units and assets that we have. That's not trivial. I can say that at the front end it's very much the data that we're able to extract from the different units, and that's what we're very much doing. I can tell you that we are getting a huge intent signals from the 13 million searches that we are delivering every day to Microsoft Bing.

This trend, by itself, is once you analyze it and analyze it carefully, can be a great insight for the consolidated business unit, and this is definitely something that we're busy right now. And we're able to see a great lift even though we are in—still in initial stage of how data that is being injected from CodeFuel or from Undertone is definitely helping Content IQ and vice versa.

So all in all, I think that two years from now, we are basically can offer advertiser, and I said that we are getting prepared for a cookie-less era through our all in all. We are developing our own world garden, which advertisers were able to put their ads in a complete control, safe environment which they're able to control their content, their layouts, they're able to control very much the audience that we're targeting, enjoy insights of data that we get from CodeFuel, all in all, to get way higher return on ad spend and enjoy first-party data and not being relying on third-party and things which we expect that two years from now will be off the table.

We are building all this in order to serve better our advertiser. Currently, we are serving around almost 700 to 800 campaigns a year at Undertone, and we're dealing with the Fortune 500 customer, and we are building together this offering, which will, in a way, need to handle the situation or that is going to be a year from now through the all in all that we're acquiring and other assets that we have from other business units.

Derek Bobbe

That's great. Really appreciate the color, Doron, and congratulations again on demonstrating resilience during a very difficult time. It's been a long journey for Perion, and just wonderful to see how well you tell about not that you've improved the balance sheet and working from a position of strength within a difficult market environment. Thank you very much.

Doron Gerstel

Thanks again.

Operator

Thank you, sir. Ladies and gentlemen once again if you've have any questions or follow-up questions please press star, one on your telephone keypad.

We'll now go to Mr. John Nobile calling in from Taglich Brothers. Please go ahead. Your line is open, sir.

John Nobile

Hi. Thanks again Doron and Maoz for taking my questions on this call. I just wanted to get a little better understanding of certain things that you used in the press release related to Pub Ocean. In that press release, it stated that the integration of Pub Ocean into CIQ will benefit a new media supply chain. Could you talk a little about this new media supply chain? How will this benefit brand recognition?

Doron Gerstel

Yes, the new media supply chain has to do with content recommendation. You need to distinguish between the current tactics that content IQ is using, where they drive their audience mainly from

Facebook through their buying platform, and what Pub Ocean is doing, which is driving their audience from content recommendation engine. That's completely two different channels. And combining these two into a one buying system, this is very powerful in order, of course, to reduce the cost of driving audience, and allows us that the profit per session—to optimize the profit per session. That's very much what is behind this acquisition.

Just to translate it into numbers. Because we are—currently, Pub Ocean is profitable, and it has its own great, great business. If you add it to the existing business of Content IQ, that's what you're coming into the $25 million and the $5 million EBITDA because at—on any given point of decision, you can ask, and this is the AI element that we're using is what is the best way to get this audience. Is it through our Facebook buying system or through the content recommendation? That's a very, very sophisticated but very essential type of technology, as I said, that can allow us to reduce substantially the cost of acquiring audience.

John Nobile

Okay. I appreciate that additional color on that. A lot of my questions have been addressed, but I just have one further question. If you could actually provide us with an update on your collaboration with Check Point's ZoneAlarm and your CodeFuel division?

Doron Gerstel

Yes. Yes, definitely. So, the ZoneAlarm and Check Point was—in our presentation, is only one example out of the thousand partnerships that we have. It is very much showing the value that we're able to bring to this enterprise, because at this point, nobody is very much paying for extensions. The only way for you to monetize your efforts, in this case, the Check Point acquisition of ZoneAlarm, is very much through the fact that you are getting your rev share from searches that's going through us, and we are very much optimizing the ZoneAlarm search results page in order for them to get the most rev share from any keyword that their user is typing in. So, that's very much it.

It's going very well. I think that the best way for us, and I think that it's something that we need to address in next call is what we call the lifetime value of those users. Lifetime value is the time that from the download and start basically using the extension and start generating search keywords till they remove the extension. That's a very important KPI that we are using to rank the extension and its revenue and EBITDA contribution. I can—since you mentioned the ZoneAlarm is very much up because they're providing a true value to their user and their lifetime value is strong, and one installation is bringing a lot of revenue—a lot of searches that translated into a rev share for both companies, for us and for Check Point. What was the other thing that you were asking other than Check Point?

John Nobile

Oh, I just really wanted to get an update on how that was going as far as that collaboration.

Doron Gerstel

Yes. So yes, that's—while they're improving very much their extension and they update the user. We definitely enjoy because it means that the users are active, they're adding new users and their existing users are staying longer because they're providing more value, more features into their installation.

John Nobile

That's good to hear and thanks again for the additional information on that. Thank you.

Doron Gerstel

Thank you.

Operator

Excellent sir. Ladies and gentlemen, once again if you have any questions or follow-up questions please press star, one on your telephone keypad at this time.

Okay. We do not appear to have any further questions at this time. I'll turn the call back over to Mr. Doron Gerstel for any additional or closing remarks.

Doron Gerstel

Yes. I would like to thank you again for joining our call. It's definitely—it was a challenging quarter, and we are very happy here. Management and teams that we're looking at second half and have more visibility and able to share our optimism. I hope you guys are all okay. Looking forward talking with you in the coming days. Thanks so much for joining. Bye-bye.

Operator

Thank you much, sir. Ladies and gentlemen, that will conclude today's conference. We thank you much for your attendance. You may now disconnect. Have a good day.