

# **Matrix Service Company (MTRX) Q2 2024 Earnings Call Transcript**

Seeking Alpha - Earnings Call Transcripts

February 8, 2024 Thursday

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**Length:** 5439 words

**Byline:** SA Transcripts

**Body**

Matrix Service Company (MTRX)

Q2 2024 Earnings Conference Call

February 08, 2024, 10:30 AM ET

Company Participants

Kellie Smythe - Senior Director, Investor Relations

John Hewitt - President and Chief Executive Officer

Kevin Cavanah - Chief Financial Officer

Conference Call Participants

John Franzreb - Sidoti & Company

Brent Thielman - D.A. Davidson

Presentation

Operator

Good morning and welcome to the Matrix Service Company Conference Call to discuss Results for the Second Quarter of Fiscal 2024. Currently, all participants are in a listen-only mode. [Operator Instructions] As a reminder this conference call is being recorded.

I would now like to turn the conference over to today's host Ms. Kellie Smythe, Senior Director of Investor Relations for Matrix Service Company.

Kellie Smythe

Thank you, Valarie. Good morning, and welcome to Matrix Service Company's second quarter fiscal 2024 earnings call.

Participants on today's call will include John Hewitt, President and Chief Executive Officer; and Kevin Cavanah, Vice President and Chief Financial Officer. The presentation materials we will be referring to during the webcast today can be found under Events and Presentations on the Investor Relations section of matrixservicecompany.com.

Before we begin, please let me remind you that on today's call, we may make various remarks about future expectations, plans and prospects for Matrix Service Company that constitute forward-looking statements for the purposes of the Private Securities Litigation Reform Act of 1995. Actual results may different materially from those indicated by these forward-looking statements because of various factors, including those discussed in our most recent annual report on Form 10-K and in subsequent filings made by the company with the SEC. To the extent we utilize non-GAAP measures, reconciliations will be provided in various press releases, periodic SEC filings and on our website.

Before I turn the call over to John Hewitt, I'd like to share that Matrix will be presenting at the upcoming Sidoti Small-Cap Virtual Conference on March 13th and 14th. If you'd like additional information on this event or would like to have a conversation with management, I invite you to contact me through Matrix Service Company Investor Relations website. I'll now turn the call over to John.

John Hewitt

Thank you, Kellie, and good morning, everyone. When we think about the safety risks present in the construction industry, we often think about the physical risks to people, but there are equally significant risks that have to do with mental health and well-being. Mental health issues arise to a variety of reasons, loneliness, high pressure work environments, seasonal layoffs, lots of a family member or friend, and can manifest in different ways, including loneliness, anxiety, depression, suicidal thoughts, and substance abuse. The construction industry has one of the highest suicide rates of any industry when compared to all other construction fatalities suicide occurs five times more often. This is why the construction industry is taking a collaborative approach to better understand mental health issues by providing research-based solutions.

Through our participation in the Construction Industry Institute, and Construction Safety Research Alliance. Matrix is directly involved in this effort. Matrix is also committed to doing all we can across our job sites and office locations, and we're doing so through a cross functional internal initiative Matrix Cares. We believe that together, we can make a difference for our own employees, and others across our industry. And I believe the mental and physical safety of our employees as well as those visiting our offices or job sites is the most important thing we can do as coworkers and leaders.

Now let's talk about business. I am proud to announce that with awards of $233 million in a quarter, we've achieved a record backlog for Matrix of $1.45 billion. This is an all-time high for the company in its 40-year history and is an achievement that is the result of the hard work of our people and our focused strategic approach in our core markets. We have transformed our organization to be more cost efficient by ensuring our skills, expertise, and strong brand are aligned with our core markets. We are positioned to safely execute projects with improved operating processes, while continuing to deliver best in class quality for our customers. As you will see, when Kevin walks through our results, Matrix has resolved the primary issues that have plagued us the last few years. We have completed projects that were bid into highly competitive pandemic environment, which resulted in limited margin opportunity. We also streamlined and refocused the company, restored our direct gross margins to our historical double-digit range, rebuild our backlog to historic levels to support higher revenue volumes in the coming quarters, and improved our liquidity position and reduced our debt to 0. A dramatic improvement in both the volume and quality of the projects in our backlog, we expect revenue volume to grow and as such, leverage our streamlined cost structure, which will resolve our final issue.

Now I want to spend a few minutes on our work in the energy markets. Recently, President Biden paused pending and future permits to export LNG to non-free trade agreement countries. Generally, we do not expect this pause to impact our opportunity pipeline or backlog. A small to mid-scale LNG facilities we have won and are pursuing are domestic in nature, riding backup fuel supply, heat shaving, or ship bunkering. Any LNG tank projects that are related to large scale export facilities that might be associated with the current White House permit position, are more of an opportunistic pursuit for Matrix. We have significant opportunities in the small-to-mid scale LNG market I just described as well as NGLs, ammonia, and hydrogen and expect these opportunities to continue contributing to backlog.

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While the transition to a low carbon energy mix has been a focus on global energy policy, the world is still heavily dependent on fossil fuel, and will be for the foreseeable future. At the same time, energy companies are actively at work developing longer term, more sustainable energy solutions. For Matrix, our expertise in both the traditional and emerging energy markets, together with our longstanding reputation for safe, quality delivery, positions us as a leading contractor across the entire industry and puts us in to the advantageous position. Our opportunity pipeline remains steady at $5 billion, demonstrating the strength of our markets and our ability to continue our long-term trend of backlog growth. We remain a contractor of choice for work in traditional oil and gas, including the engineering and construction of crude storage tanks and terminals, ongoing maintenance repair work, refinery turnarounds, retrofitting for renewable fuels, and the installation of natural gas processing infrastructure. With increasing use of LNG as a low carbon solution for ensuring reliable and affordable power for electricity, heating and cooling, and also an alternative fuel for high horsepower applications. Matrix has emerged as a leader in the design, construction, maintenance, and repair of LNG storage tanks and balance of plant facilities.

Major energy companies also rely on us for NGL storage tanks, terminals, such as ethane, ethylene propane, and butane that feed the global marketplace because of our country's vast, safe, and dependable natural gas availability. Looking forward, the transition to sustainable energy is a broad initiative and will include, among others, hydrogen. This is a market that while not presently a significant revenue driver for us will be as we assume a major leadership role and fulfilling the significant infrastructure needs that will evolve. This has creation of our strong market position in LNG was made possible because of our specialty vessel, cryogenic capabilities. The hydrogen market requires these same specialized skill sets. In the not market that will develop overnight, nor is the one that that any contractor can simply step into once it's developed. Same is true for ammonia, methanol, as energy carriers and a means of transporting hydrogen. Drawing on our extensive cryogenic engineering and construction expertise, Matrix is already at work laying the foundation needed to ensure we were at the forefront in providing the needed solutions in this space. For example, we have completed construction of a hydrogen sphere in the southwestern U.S. and are beginning the engineering for a liquid hydrogen storage sphere for a client on the West Coast, which we will also construct.

We're also actively at work on a FEED study for a hydrogen production, and distribution facility and working on a feasibility study for a global energy company to develop large scale liquid hydrogen storage solutions. With an increasing number of hydrogen and ammonia opportunities internationally, we are building strategic relationship with construction organizations, like that recently announced with Tissot Industries and other European partners, which provide the ability to offer complete EPC solutions Across the European Union, United Kingdom, Norway, Switzerland and elsewhere. As shared last quarter, we had communication with several of our long-standing clients, who are also part of the hydrogen hub teams identified to receive funding under the Bipartisan Infrastructure Law. Of course, we continue to be active in our other end markets with robust opportunities and growth potential across each of our reporting segments.

As I've said before, our organization has been meaningfully transformed over the past few years, and that transformation is showing up on our performance. We continue to fine tune the organization and are investing in the technology, systems and personnel needed to execute our strategy and grow the business. I'll hand the call over to Kevin to review the results.

Kevin Cavanah

Thank you, John. The overall results for the second quarter were in line with our expectations While revenue was a bit lower than expected, direct margin performance, cost management, bottom line performance, backlog, and liquidity were all at or above our expectations. We generated awards of $231 million resulting in a book to bill ratio of 1.3, our 10th consecutive quarter at or above 1.0. With these awards, we have increased our backlog to $1.45 billion, the highest in company history. Backlog has increased 95% in the last year and 33% in the first half of fiscal 2024. Revenue of $175 million in the second quarter was on the lower side of our range of expectations. The decline compared to first quarter revenue of $198 million related primarily to the normal timing of project execution on storage construction projects with the first quarter benefiting from a high level of project procurement.

As I mentioned last quarter, our backlog contains larger long term construction projects. There is an inherent lag between the time when a project is awarded and when it begins to have a material impact on revenue. In some cases, this lag can be between 3 and 6 months or longer. The contribution to revenue from these projects has been minimal thus far as each move through scope finalization, engineering and planning stages at its own pace. We expect revenue from these projects to increase modestly in the third quarter and then pick up meaningful in the fourth quarter and the remain at elevated levels throughout fiscal 2025 and 2026.

In the meantime, we are encouraged that direct gross margins return to historical double-digit levels in the first half of 2024. Project execution was strong once again, but was offset by under recovered construction overhead resulting from the low revenue volume that impacted gross margins by almost 500 basis points. The result was a gross margin of 6%, which was consistent with the first quarter. We expect to see improved overhead recovery in the third quarter and to achieve full recovery in the fourth quarter as a result of the revenue ramp we previously discussed.

Organizational efficiencies achieved over the last several years continue to benefit our cost structure. Consolidated SG&A expenses were $15.7 million in the second quarter, which is the lowest level since the first quarter of fiscal 2014. This compares to $17.1 million in the first quarter. The decrease in second quarter was primarily attributable to a reduction in expense associated with the variable accounting for cash settled stock compensation and lower project pursuit cost. The company will continue to control costs in order to leverage SG&A but expects to see modest targeted increases to support revenue growth as the year progresses.

Other income during the second quarter included a gain of $2 million on a $2.7 million sale of a facility in Catoosa, Oklahoma. The facility was previously utilized for our industrial cleaning business, which was sold during the fourth quarter of fiscal 2023. This completes the divestiture and closure of non-core service offerings as part of our strategy to focus the business on our core markets. As expected, the effective tax rate was near 0 for the second quarter, and we expect the effective tax rate to be around 0 throughout the remainder of fiscal 2024. For the second quarter of fiscal 2024, we had a net loss of $2.9 million or $0.10 per fully diluted share, which was similar to the net loss $3.2 million or $0.12 per share in the first quarter.

Moving to the operating segments. In the Storage and Terminal Solutions segment, revenue was $62 million in the second quarter, as compared to $90 million in the first quarter of fiscal 2024. First quarter revenues for this segment were positively impacted by the procurement of materials and components for construction projects awarded in the prior fiscal year. We did not have a similar level of procurement in the second quarter. We expect higher revenue volume as we move through the remainder of fiscal 2024 and into fiscal 2025 as large specialty storage project awards transitioned through contracting, project planning, and mobilization, and into field construction. Gross margin was 2.9% in the second quarter as strong project was execution was negatively impacted by 770 basis points from the under recovery of construction overhead costs due to the lower revenue. We have allocated additional resources to this segment to support recent awards, a significant opportunity proposal pipeline and the related additional revenue that we expect in the coming quarters. With revenue increases in this segment, we expect to reach full recovery of construction overhead costs in the fourth in the first quarter.

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In the utility and power infrastructure segment $40 million in the second quarter compared to $32 million in the first quarter as revenue begins to benefit from peak shaver projects previously awarded. We expect LNG peak shaving revenue to continue to increase as we move through the second half of fiscal 2024. Gross margin was 3.5% in the second quarter of fiscal 2024 as good project execution in this segment was offset by almost 600 basis points from under recovery of construction overhead costs. We've allocated additional resources to this segment as well, to support recent awards, a strong bidding environment, and related anticipated revenue growth. As revenue continues to increase in this segment, we expect to reach full recovery of overhead costs in the fourth quarter of fiscal 2024. And finally, in the Process and Industrial Facility segment, second quarter revenue was $71 million, which was slightly lower than the $75 million in the first quarter. We expect revenue to remain at similar level as we move through the remainder of fiscal 2024 and then increase in fiscal 2025 related to previously awarded construction work. The segment gross margin was 9.4% in the second quarter compared to 6.8% in the first quarter. With project execution strong in both quarters, we also reduced construction overhead costs in the second quarter by allocating resources to other segments, as I noted previously.

Now let's discuss our financial position. Liquidity increased to $106 million an improvement of $26 million in the quarter. Positive net cash inflows of $30 million from operations allowed the company to repay all outstanding borrowings on our credit facility of $10 million and increase our cash balance by $20 million. We expect to see cash and liquidity also improve in the second half of fiscal 2024. We'll continue to proactively manage the balance sheet to support the improving business and believe we have the liquidity to support our financial needs, including funding working capital for the normal spring peak and reimbursable work, funding construction projects that are in a prepaid position and targeted capital expenditures to support operations. As we move forward and continue to strengthen our balance sheet, we will evaluate our approach to capital allocation to ensure we are creating value for our shareholders. That concludes my prepared comments. So I'll now turn the call back to John.

John Hewitt

Thank you, Kevin. Before we open for questions, I'd like to reiterate some key takeaways for today. First, with record high backlog, we expect to see a marked improvement in revenue volumes in the near term. Those higher revenue volumes will provide for better construction overhead absorption, leverage of SG&A, and improved bottom line performance. But it's difficult in our business to accurately predict the timing of awards, starts at backlog version of revenue, we are highly confident in this outlook. Second, we believe our strategic approach to our strong end markets, clients and services to help us maintain a sizable opportunity pipeline and lead to further backlog growth and strong performance well into the future.

Third, organizationally, we are leaner and more efficient. We'll continue to invest in the process, systems and people needed to drive performance improvement and deliver strong project execution. In conclusion, there was a lot of positive momentum in the business, and we are well positioned to maximize our profitability and generate value and growth for our stakeholders. I'd like to open the call for questions, and then come back to you for some closing thoughts.

Question-and-Answer Session

Operator

Thank you. [Operator Instructions]. Our first question comes from the line of John Franzreb of Sidoti & Company. Your line is open.

John Franzreb

Good morning, everyone, and thanks for taking the questions. I like to start with the gross margin profile in the second quarter. Considering how much revenue was down and when you look at it versus a year ago, was sizably better. How much reflects the absence of unprofitable jobs and how much reflects new jobs priced appropriately in that mix. Can you give us a sense of what drove the margin in the quarter?

Kevin Cavanah

So as I as I talked about on the call, the direct gross margins in the quarter, were strong back in the double digit area that we've been striving to get to. That's the result of the quality of bookings that we've had over the last year, year and a half. If you look at the same period last year, the direct margins were extremely low - low single digits. And that was because of the combination. We were still working off the COVID backlog. We were still continuing to work on a project that was, very difficult for us to complete in a profitable manner. So when you look at the margin performance quarter-over-quarter It's an extremely big improvement. I don't have to split between what's related to new projects versus the old, but it's sufficed to say the margin performance, is that where we need it to be on these projects. Now what's left is to get the revenue volume up to where we want it. So we can fully recover our construction overhead.

John Franzreb

And Kevin, just for clarity sake, what's your definition of direct gross margins?

Kevin Cavanah

So I think about direct gross margins, it's the actual margin that I'm earning on each individual job and when I think about gross margin, it's the combination of those direct margins on jobs, combined with the recovery of our construction overhead pool of costs that we utilize to manage all those projects. So when we get to a period where we've got the right volume, we're fully recovering those overheads and Therefore, the direct gross margins is fairly equal to the gross margin. In a period where our revenue volume is low, and we're not fully recovering that under recovery can have a very significant impact on our margins as it as it did this quarter, almost 600 basis points. So that's something that's extremely important for us to manage, and it's the it's the one item that John noted in his comments that that we've still gotta, finish getting that completed. We completed everything else. We've just gotta get that strong backlog we've booked the last year plus to convert to revenue, which we think is coming.

John Franzreb

And, John, regarding the awards cycle, what innings do you think you're in? Is it unreasonable to assume that you can persist at the current rate of awards?

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John Hewitt

No. I don't think that's unreasonable. I mean, you know, the again timing – timing is everything. And, whether quarter after quarter, it's gonna be above 1 or not, but certainly think we're in a position to exit the year with a one plus on awards and our book to bill and projects that are in our pipeline, you know, a variety of sizes. So we think we'll continue to contribute to backlog well out in the future. So we think we're in early innings in our ability to continue to and add good projects to backlog and continue to build and grow the business.

John Franzreb

Okay. Got it. That sounds great. And one last question. If I heard correctly in the prepared remarks, it sounded like that the revenue outlook is strong through fiscal 2026 based on the current bookings profile that doesn't assume any incremental new awards. Is that the proper understanding?

Kevin Cavanah

Well, so we're we always have a portion of our revenue that's what we call book and burn that that will get awarded and we'll burn it off in the next quarter or two and then we have the larger projects that are - have a have a two and a half, three-year, construction period. So, when we make comments like that, with these larger projects we've added to backlog, we've got much better visibility into the total revenue stream for 2025 and 2026 that gives us the confidence to make that statement.

John Hewitt

If I add on to that, John, I would say the backlog in place now helps us lay a foundation for the future. And then overlay what we see in the opportunity pipeline, gives us confidence that we're gonna be able to have a strong revenue stream here out over the next couple of years.

John Franzreb

Great. That's great, John. I appreciate it. I'll get back into queue and let somebody else go. Thank you.

Operator

Our next question comes from the line of Brent Thielman of D.A. Davidson. Your line is open.

Brent Thielman

Hi. This is Jean Ramirez for Brent Thielman D.A. Davidson. I'll start with the revenue question. Should we see some revenue progression from fiscal quarter - from the second fiscal quarter to third? It seems like this should be sort of a trough for revenue given the sizable backlog today.

Kevin Cavanah

Yeah. We would agree with that. I think this will be a the low point of the fiscal year. You'll see some decent growth here in the third quarter and then should be higher growth in the fourth.

Brent Thielman

Okay. Thank you. Just interviews on the refinery turnaround season and activities you performed there. Just wanted to see if it's a better or worse, relative to the past few years.

Kevin Cavanah

I mean, we're entering our refinery turnaround cycle. Basically, now we're sort of in it. Majority of our refinery turnaround work is located in the Pacific Northwest. And, I don't know if there was anything unusual this year versus last year, I would say I'd probably point it as sort of an average turnaround cycle for us in the facilities that we work.

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Brent Thielman

Thank you. And one more question. So you mentioned some favorable direct margins. Are those continuing to get better with New York - with the work awarded in New York, or I guess in other words, do the bid margins keep moving higher because the market's so busy right now?

John Hewitt

I think what I would the way I would look at it is When we look at the margin performance in the first half of fiscal 2024, we've had some good project closeouts. On completing some projects that have moved that margin up. I'm really overall strong execution by our field that has helped that. I think that'll be replaced by the quality backlog that we've got. Those projects should lend themselves to a similar level of margin. So I wouldn't expect - we'll continue to strive to - maximize the direct margin performance but I wouldn't expect, direct margins to go significantly higher than our the 10% to 12% range that we've talked about being the normal range for the business. And you also need to remember that 30%, 40% of our business is reimbursable and a lot of maintenance activities, that type of work, really good work for us. But it leads itself to a lower margin profile. So instead of double-digit margin for we're in the high single digits for that type of work.

Brent Thielman

Perfect. I appreciate the color. I'll hop back in and let someone else ask some questions.

Operator

Looks like we have a question from John Franzreb of Sidoti & Company. Your line is open.

John Franzreb

Thank you. John, just back to the hydrogen discussion, I might have missed this. You said it was small, but put it in context how much business you do in the hydrogen market. What do you think maybe the potential is and the timeline for realizing that kind of a potential?

John Hewitt

So I think, you know, obviously, it's about, you know, how fast the at least the U.S. transitions to a higher percentage of hydrogen in the energy mix. I think we feel pretty comfortable long term that hydrogen will take a larger position in the U.S. energy mix. Whether that's for, certainly in industrial processes, but, for, as a, a fuel for transportation fuel, and then for, some kind of a mix or blending for power generation. So I think what you're seeing, what we're seeing right now is a lot of, kind of foundation for us, laying the foundation for that future, were a lot of time spent on marketing, time spent on providing feasibility and FEED studies to various clients to help them with their decision making profile on what their next steps are, picking up an occasional, storage sphere or an occasional, maybe smaller, hydrogen processing facility. So I think it's gonna continue to grow for us. So but I think, you know, we're probably a couple of years away from a hydrogen, from a material impact on our backlog and revenues from hydrogen.

That said, you know, I would expect here over the next 12 to 18 months, and we'll continue to add small hydrogen related projects into our backlog and that should continue to grow over the subsequent years.

John Franzreb

Understood. And just a little bit about the leverage discussion. Kevin, you suggested that the second quarter SG&A was artificially low, due to timing of, I guess, bonus accruals and other items. But you also said that you expect to leverage the SG&A line rather significantly in the year ahead. So how should we think about SG&A, on a go forward basis, similar to maybe the first quarter? marginal increase. Just any color on that line would be helpful?

Kevin Cavanah

I think the second half SG&A will probably be higher than the first half was. The variable accounting on cash settled stock based compensation. We'll have a higher expense. We also anticipate increased, project pursuit cost as we continue to work to build the backlog and then you know, than just some other targeted increases that we'll need just for the added revenue volume that comes. The way I think about SG&A is we've got a target out there we're trying to get the SG&A to 6.5%. I think we'll make a significant move toward that especially in the fourth quarter. I'm not sure we'll get all the way there, but we can definitely get, a much closer. Hopefully, we get to 7% or lower. And then then I think that's achievable mark in fiscal 2025.

John Franzreb

And when you talked about asset relocations, just about moving guys from, personnel from process into utility in stores, not adding, additional personnel. Am I understanding that properly?

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Kevin Cavanah

Yes. For the there's really two aspects of the construction overhead. So first of all, when we talk about reallocating resources, we've talked about the fact that our staffs can work in multiple segments and if you look at the volume of revenue that was flowing through the process and industrial facility segment last year, it was definitely a higher percentage. That we completed some of that work, and I mentioned that we're kind of in a low period here before additional work kicks in. So those resources are being allocated toward the other two segments. And when we try to put a little more color on those resources, what those are, that's all the project management, the quality, the safety, all that infrastructure we have in place to execute the projects will be more focused on those other two segments, in the second half of the year than they were in, say, the prior year.

John Franzreb

Okay. And just lastly, on the long-term financial targets, any kind of update when we would expect to realize those targets, is that a exit philosophy ending this 2025? Or what are your thoughts there?

Kevin Cavanah

I think, again, it's similar probably to the answer on, SG&A. I think you can see significant movement, toward those targets at the end of the in the fourth quarter. Will we get there all the way? I'm not sure about that, but I do think those are achievable in in the in fiscal 2025.

John Franzreb

Great, guys. Thank you for taking my follow ups.

Operator

It looks like we have follow-up questions from the line of Brent Thielman of D.A. Davidson. Your line is open.

Brent Thielman

Hi. Just thinking about CapEx Can you give us a sense of how we should be modeling, CapEx for the year or the next couple of years? Just, should we think of the is it tied to revenue growth pursuing there are some costs to support all of this growth, right?

Kevin Cavanah

It is tied to revenue growth, and it's also tied to the fact that as we've been trying to control costs the last few years, we've held our capital spending pretty low. So I'd expect it to increase. We've put a long-term target out there at 1.5% of revenue. I think we'd probably be around that level for the second half of the year or potentially a little higher as we as we kind of almost you ramp up some of that CapEx for the for the revenue volumes that are coming. I don't have a fiscal 2025 CapEx budget at this point, but I would expect we'd probably be at least at the 1.5% next year or potentially a little higher.

Brent Thielman

And, for fiscal year 2025, when you say a little higher, is that compared to the second half of the, fiscal year 2024 or just in general, a little higher than 1%?

Kevin Cavanah

I'm talking I'm talking a little higher as a percent of revenue. So when I talk about the 1.5% of revenue, it could be it could be 1.8 or 2%. But, again, I don't have a I don't have a developed CapEx forecast yet. I'm just anticipating that there will be needs for portions of the business that are growing.

Brent Thielman

Perfect. Makes sense. I appreciate the follow-up. Thank you so much.

Operator

Thank you. I'm showing no further questions at this time. I'd like to turn the call back over to John Hewitt for any closing remarks.

John Hewitt

I wanna thank everybody for being on the call today. I hope it's clear that there are a lot of great things happening in in the business. And that, we are positioned for significantly improved bottom line profitability as you look out into the out into the short term here. So you very much for your time today and everybody. Please be safe. Thank you.

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Operator

[Operator Closing Remarks].

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