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SLANG Worldwide Inc.

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CORPORATE PARTICIPANTS

John Vincic
SLANG Worldwide Inc. — Investor Relations, Vincic Advisors

Peter Miller
SLANG Worldwide Inc. — Chief Executive Officer

Kelly Ehler
SLANG Worldwide Inc. — Chief Financial Officer

CONFERENCE CALL PARTICIPANTS

Noel Atkinson
Clarus Securities — Analyst

Bobby Burleson
Canaccord — Analyst

Paul Piotrowski
M Partners — Analyst

PRESENTATION

Operator

Good morning. My name is Amy, and I will be your conference Operator today. At this time, I would like to welcome everyone to the SLANG Worldwide Third Quarter 2019 Conference Call. All lines have been placed on mute to prevent any background noise.

After the speakers' remarks, there will be a question-and-answer session. If you would like to ask a question during this time, simply press *, then the number 1 on your telephone keypad. If you would like to withdraw your question, please press the # key. Thank you.

Mr. Vincic, you may begin your conference.

John Vincic — Investor Relations, Vincic Advisors, SLANG Worldwide Inc.

Thank you, Operator, and good morning, everyone. Our speakers on today's call will be Peter Miller, Co-founder and CEO of SLANG Worldwide; Billy Levy, Co-founder and President; and Kelly Ehler, Chief Financial Officer. Joining them for the Q&A session will be Mike Rutherford, VP of Finance.

Before we begin, I would like to remind listeners that certain statements made during this conference call presentation may constitute forward-looking information and forward-looking statements within the meaning of applicable securities laws. These statements involve known and unknown risks, uncertainties, and other factors which may cause the actual results, performance, or achievements of SLANG Worldwide and its subsidiary entities or the industry in which it operates to be materially different from any future results, performance, or achievements expressed or implied by such forward-looking statements. When used in this conference call presentation, such statements use words such as may, will, expect, believe, plan, and other similar terminology. These statements reflect management's current expectations regarding future events and operating performance and speak only as of the day of this presentation.

These factors are discussed in detail under the heading Risks and Uncertainties in SLANG's Management Discussion and Analysis dated November 25, 2019, and filed on SEDAR. The Company undertakes no obligation to update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise, other than as required under securities legislation.

And now I'd like to turn the call over to Peter Miller. Peter?

Peter Miller — Chief Executive Officer, SLANG Worldwide Inc.

Thanks, John, and thanks, everybody, for listening to this quarter's earnings call. We know that time is precious and we will do our best to be efficient here, as the message we have is both simple and timely.

SLANG continues to demonstrate strong organic growth and looks toward a profitable acceleration of these trends into 2020 and beyond. With the announcement of today's financing, we now do this with a significant amount of cash on our balance sheet at a dynamic time in the market when, more than ever, cash is king.

SLANG's business model was built at a time before the capital markets were focused on the US opportunity. As such, the business model wasn't built to rely on those sources of capital but was optimized to rapidly scale when those sources became available. The idea was simple. Produce great products that deliver on their brand promises and sell those products into scaled consumer markets. With today's equity financing, we are even better positioned to scale.

This financing comes largely from existing long-term institutional shareholders. We expect that more traditional debt will become available to profitable businesses in the space and that we will be well-positioned to use it. In the meantime, however, we are excited to focus on our expanded growth strategy rather than on refinancing or servicing the cumbersome debt instruments that are more broadly available.

In the quarter, we delivered strong organic revenue growth, increasing gross margin as we continue to optimize efficiency across the network. Due to continuation of these activities, we have a clear line of sight on positive cash flow and overall profitability. Part of the optimization of efficiencies included in the completion of the work required to exercise the option to acquire certain supply chain assets, including ACG in Colorado which we exercised subsequent to the quarter. We will look forward to the increase in profitability and cash generation that this asset will support in the Colorado market.

In Q2, we commented on our outlook for the more emerging markets. We shared why we thought certain markets were not on track to receive the investments needed to fully operationalize profitable businesses. These markets included newly legal states like Massachusetts and Michigan.

In Q3, we saw the growing pains in those markets persist, with Massachusetts taking the most drastic position in face of concerns around liquid vaping, while the more mature markets took a more measured approach. As the situation around vaping concerns unfolded, our core market showed the most resilience. Additionally, our diverse portfolio was able to offer alternative products to those looking. The concerns around this issue were largely resolved by the CDC determining that vitamin E acetate was the primary culprit, a product largely limited to the illicit market. However, the episode demonstrated the durability of our model and the value of having a diversified portfolio. We certainly saw a shift to the more premium end of our liquid vape products and an increase in demand for our dryer vaporizer. With clarity on this issue, we look forward to a clear path for the growth of our entire portfolio into 2020.

Another reason for optimism, as counterintuitive as this may sound with recent commentary in mind, is the Canadian market. This is a market that everybody believes has potential, but some fear always will. While distribution leaves a lot of room for improvement, it appears that the Ontario and Alberta provincial buyers are particularly engaged in moving toward Cannabis 2.0 products. As a matter of fact, the Ontario government buyers are at our Canadian network facility right now as this call is taking place, inspecting finished goods, including the Firefly Mini, O.pen cartridges and the Bakked Dabaratus. SLANG products received great feedback at the Canadian legalization anniversary event held by the OCS and we're getting strong indications of interest across the board for these products. We look forward to sharing developments as they unfold.

Canada is a great example but not the only example of an emerging market which is showing signs of growing through early challenges and becoming more conducive to SLANG's core market business model. The incredible growth and patient participation in Oklahoma is a great indication of future success, and the development of the Florida market has been a bright spot for the entire sector, with our partner, Trulieve, really demonstrating operational excellence and focus to incredible ends.

With Trulieve, we launched RESERVE in Florida in the quarter and plan to expand our offerings in that market with them over time. Across both core and emerging markets, we also saw huge growth potential for SLANG in product categories which we don't currently serve, such as flower.

Subsequent to the quarter, we announced a strategic partnership with the Cookies brand for the state of Colorado. Leveraging existing relationships on both the supply side and retail distribution front, we expect this to be a very successful launch, providing us with valuable experience in flower and opening doors for us to launch other flower products from our portfolio. Flower is bigger than the entire vaping concentrates category combined and this represents a great opportunity for us to leverage the unique distribution pipeline we've built over many years. We will continue to layer additional products into the portfolio and distribute them through this pipeline where we see gaps in our portfolio and openings in the market.

In addition to flower, we see certain concentrate subcategories offering great opportunity for SLANG. To that end, we moved live resin and solventless products into the development phase. We're getting great feedback on these new formulations inside the Firefly Mini and O.pen cartridges and look forward to their commercial launch.

Inhalable products certainly aren't the only area for growth, and we are keen to build upon the success of District Edibles and Pressies through the release of new flavours and delivery formats, including sours, chocolates, and mints, in the near term.

In general, our category managers and product teams see significant untapped potential in our core markets, and we are intent to capitalize on all of it. Our emerging markets continue to show signs of favourable supply-and-demand dynamics, and we remain committed to expansion into those markets at the right time. As the market dynamics become more similar, the playbook that makes us successful in core markets is more transferable than any regulatory edge we may enjoy in emerging markets. The regional excellence, with a responsible added broad geographic expansion, is a formula we believe will be successful for ourselves, our partners, and our shareholders.

With that overview, I would like to hand the call over to my colleague, Kelly Ehler, to discuss the financial performance in the quarter and the overall state of SLANG's finances.

Kelly Ehler — Chief Financial Officer, SLANG Worldwide Inc.

Thank you, Peter. I will now walk you through the highlights of our third quarter. I will highlight key financial metrics in my discussion.

So turning to revenues. Our third quarter revenue increased 29 percent to 9.3 million, up from 7.2 million in the second quarter and pro forma revenue of 5 million in the first quarter of 2019. These solid results are a testament to having a diversified portfolio of products and the value of a strong distribution network.

Turning to our gross margin analysis. Third quarter gross profit increased 39 percent to 4.6 million, up from 3.3 million, reflective of the fact both sales went up as emergents. Product mix and pricing improvements were the drivers in this success. Our third quarter gross margins of 49 percent were closer to our target of 50-plus percent, which we consider our sustainable targeted level. We are seeing a positive impact from the integration of certain operations, a process that has been ongoing for several months. More upside is targeted as we continue integration processes and seek out synergies. The end result for the quarter is our bottom-line net income was 400,000.

I'll now break down some key areas in our financial performance. A significant line item on our income statement is impairment charges and derivative valuations, both of which are noncash items. In the third quarter, we booked derivative and exchange gains totalling 106 million and a corresponding $95 million non-cash impairment expense charged to goodwill. This reduces our goodwill to zero. Goodwill calculations at the time of acquisition back in January 2019 were driven by market valuations at the time. Since then, market valuations for us and the entire sector have reduced, and we've adjusted our goodwill balances to be more in line with current market conditions. Also, as discussed, we have exercised the option on ACG, so this aspect of the quarterly derivative liability revaluations should no longer occur with respect to that option.

Depreciation and shared compensation expenses. They were in line with the last quarter and will remain a material noncash expense going forward.

With respect to our EBITDA, our EBITDA loss was 2.8 million in the third quarter. After adjusting for certain nonrecurring expenses, adjusted EBITDA loss was 1.6 million, approximately the same as the second quarter. To reiterate, our goal is to become EBITDA positive, as Peter outlined. Factors to achieve this will be increasing sale volumes, consolidating and streamlining portions of the SLANG Network, prudent expense management. And there were a number of expense areas we identified in our ongoing integration process that we reduced without affecting operations or capacity. This will result in a reduction of cash outflows of 3 million per year. On a go-forward basis, half of this will be effected by the end of the year and the remainder over the 2020 year.

How has our cash position evolved? We had 18 million at June 30th; at December 30th, we had 11 million. Of the 7 million utilized, 2 million was at the SLANG corporate level and the balance in operations. As noted, our adjusted negative EBITDA was 1.6 million for the quarter. Our announced $15 million private placement significantly adds to our cash balance. We are well capitalized to take advantage of growth opportunities in a profitable way.

With respect to our KPIs, just a reminder, revenues increase when taking into consideration our KPIs for the quarter.

Our branded units and servings declined from the second quarter levels. Branded units were 913,000 in the quarter versus 1.1 million in the second quarter. Branded servings were 64 million in the quarter versus 74 million in the second quarter. Again, a reminder that branded units and branded servings will not necessarily match quarterly revenue trends for the following reasons: we recognize revenue upon shipment of the product, unit and servings are based primarily on timing of retail sales, and a serving is based on a 5 milligram of cannabinoid content. And we expect to see fluctuations quarterly.

Back to cost management, and to reiterate, we said last quarter that we have been working on integration of the acquisitions we completed at the time of our IPO. And as noted above, regarding cash total reduction between the network and direct entities is over 3 million in annual savings. We are well-positioned to execute our growth strategy and take advantage of market opportunities. Our primary goal is positive cash flow and profitability for 2020.

At this time, I will turn the call back to Peter for some concluding remarks.

Peter Miller

Thanks, Kelly, and thanks, everybody, for listening. We're proud of the third quarter results, our current capital position, and are more enthusiastic than ever about the prospects for SLANG. The investments we made in our operating and corporate infrastructure from Q1 to Q3 position us very well for the balance of 2019 and 2020.

Aggregate consumer demand continues to grow, while many political, regulatory, and technological tailwinds all point to an incredible overall opportunity for our industry. Things will not be perfectly smooth, but the overall opportunity we see in the market is thrilling and we are incredibly motivated to capitalize on it.

Thanks, everybody, for listening, and at this point, we would be happy to take any questions.

Q&A

Operator

At this time, ladies and gentlemen, if you would like to ask a question, please go ahead and press *, then the number one on your telephone keypad. Again, that's *, then 1 to ask a question.

Your first question today comes from the line of Noel Atkinson of Clarus Securities. Please proceed with your question.

Noel Atkinson — Clarus Securities

Hi. Good morning. Congratulations on a really solid quarter overall. I just have a few quick questions here. In terms of the ACG exercise of that purchase option—and congrats on moving forward on that—are you still structuring this as a payment of 33 million SLANG shares for that acquisition?

Peter Miller

Yup. Hey, Noel. Thanks a lot. And yes. That's exactly right.

Noel Atkinson

Okay. Is there any cash component to that?

Peter Miller

There is not.

Noel Atkinson

Okay.

Peter Miller

No.

Noel Atkinson

Great.

Peter Miller

It's straight shares.

Noel Atkinson

Can you provide a targeted closing date for the transaction?

Peter Miller

That will just be regulatory-driven, but we've exercised—we have our ducks in a row and we think it can happen very efficiently.

Kelly Ehler

But just, I'll just say from an accounting perspective that we will be consolidating their financial results. Notwithstanding, the licence is not transferred at this point.

Peter Miller

Yeah. The auditors will require financial consolidation as the control shift has taken place through the exercise of the option. But the close, we'll be moving toward as quickly as possible.

Noel Atkinson

So what would be the date in which the consolidation of the revenues would begin?

Kelly Ehler

November.

Peter Miller

Yeah. Roughly around now.

Noel Atkinson

Okay. Okay. Great. Are you able to provide any pro forma details of the financials for ACG in Q3 or H1 '19?

Peter Miller

No. We're not guiding to that specifically. But I will say, as part of the consolidation of the Colorado assets and what we're modelling in other core markets, when we bring these things together, we start really seeing the profitability, and in the case of Colorado, generation of cash that's really encouraging. Because ultimately, I've said this in a few different places and at different times, but we see Colorado as one of those markets that gives you insights into future markets. It's been around longer than any other market from a legal recreational standpoint. There's been a lot of competition come and go. We've seen wholesale prices decline and then rise again. You're starting to see, I think, as close to a market in equilibrium as you're going to see. So when we can generate cash in that kind of environment, it allows us to I think make longer-term models and grow with a lot more precision.

So Colorado excites me a lot on the profit side and in terms of I think being a bit of a bellwether for markets that have similar regulatory structures over time. And in the mature and maturing rec markets, all share common traits as they grow. So we think it's going to be a great model for what we can do elsewhere.

Noel Atkinson

Right. And it also appears to have been by far your strongest state or area in Q3 as well.

Peter Miller

Correct. Yep.

Noel Atkinson

Okay. Cool. On the cost-saving side of the 3 million that you're targeting over the next 12 months, can you provide any sort of insight in terms of how that rolls out and what you think you can accomplish in Q4 versus Q1, Q2, Q3 of next year?

Peter Miller

Yeah. I'll start at a high level, and maybe Kelly can go into more detail, but ultimately, we did bring together a few entities with their own corporate infrastructure, and there were just very basic efficiencies to find from just back office consolidation, et cetera. But if you have any other—

Kelly Ehler

Sure. I mean half the 3 million I mentioned will be effective by the end of the year so that will be on a go-forward basis in terms of reduction of cash outflows, and the balance will occur throughout the course of 2020. And we still have some other areas that we think we can still drive some synergies and efficiencies that could actually make that number even bigger.

Peter Miller

Yeah. So high level, you've got HR implications. You've got purchasing, collective, sales, et cetera.

Noel Atkinson

Okay. You folks had a pretty solid rental revenue reported in Q4 of 2018. Do you folks expect something similar to that in Q4 2019?

Peter Miller

Yeah. Since the rents are coming from a seasonally sort of revenue-generating business, i.e. a farm, and since this year was successful for that farm, I think we're going to see similar performance.

Noel Atkinson

Okay. Great. And then just my final one before I get back in the queue, and thanks for taking the call. It appears from the industry data that vape sales have stabilized overall industry wide in the past couple of months. And can you talk at all from your guys' point of view, as you're seeing it firsthand, what's going on in the vape market, in the THC vape market right now?

Peter Miller

Yeah. Sure. So I think at the initial signs of trouble, the most—I don't want to use the word reactive because it's not what it is, but ultimately, the newer states had a much smaller opportunity cost and so they were more inclined to be very conservative and impose bans. So a state like Massachusetts didn’t have much at risk in saying we’re going to delay the sale of vapes. Whereas you have a market like Colorado where vapes have been in market for many, many years without these product liability issues, and in terms of dollars and cents, vape sales are hundreds of millions of dollars at the cash register, which represents pretty significant tax revenue for the state. So it’s not so much an opportunity cost as a really hard cost, and without the right data, it’s dangerous to make these decisions. So they took more of a collect information position and ultimately, as the information came out, they didn’t wind up having to do too much. And the local consumers that were used to purchasing these products over many years, we didn’t see change their behaviour too much. And the most sort of behavioural changes we saw were in the more touristy retail locations.

And so then in more mature markets that still imposed limited bans like you saw in Washington and Oregon on the flavour side, we ultimately saw certain rollbacks and a return to the status quo. But in that period of time, there was a shift towards more premium vape devices, certainly in our portfolio. So that was Craft Reserve, and in some cases, we offered stores the opportunity to swap certain products for Craft Reserve.

So again, we saw the biggest differences industry-wise in these more touristy destinations where people didn’t have the same experience. But during the media attention on this, we did collect a lot of information and participate in a lot of industry discussions. And speaking on some panels with peers of ours in the vape space, the general theme was that there wasn’t a response to sales sort of equal to the amount of attention the situation was getting. So it’s no doubt a very serious situation. The CDC pointing to vitamin E acetate as the likely cause of the issue I think cleared some concerns for certain consumers. And ultimately, it’s a situation we continue to monitor closely.

Noel Atkinson

Okay. Great. Thanks very much.

Peter Miller

Thanks, Noel.

Operator

Your next question comes from the line of Bobby Burleson of Canaccord. Please proceed with your question.

Bobby Burleson — Canaccord

Hey, guys. Good morning.

Peter Miller

Morning, Bobby.

Bobby Burleson

So yeah, just a couple of quick ones here. We talk about the 70 million to 100 million revenue guidance for 2019. I know there's some completion of announced deals that could happen in that time frame and that could be a big swing factor between the 70 million to 100 million. If we kind of take out that aspect of the guidance, what is the kind of variability around the remainder of the year? Is it in your vape line? Whether or not there's some lingering fallout in terms of inventory reduction from the vape bans and kind of the overall vape crisis? Is that the most volatile part of your portfolio at this point? And once again, so stripping out whether or not those transactions close as a swing factor between that 70 million and 100 million.

Peter Miller

Yep. Thanks, Bobby. So I think there's going to be some stabilization that takes place for sure, as I mentioned, in Oregon where certain stores that weren't capitalized to take or hold big inventory through the period of time. Certainly, industry-wide, scaled back purchasing of certain goods and now are getting comfortable again. So I think there'll be some element of variability there.

In terms of the acquisitions closing, I don't see that—we're not seeing that as a factor right now and we're not going to guide specifically to where we land. So obviously, at year to date being pro forma in the 65.5 million range, we're on the doorstep of that 70 million to 100 million, but we haven't guided any more clearly than that.

Bobby Burleson

That's good. Thanks. And then Lunchbox Alchemy, LBA, I know that FDA originally sent out a bunch more letters to folks with product in the market where they are marketing health benefits and other things that are considered a violation. Do you think that the competitive environments are going to get a little bit more benign going forward, given the way you're positioning your product line vis-à-vis some of the guys that are maybe bad actors? What's the takeaway from the FDA's latest move ahead of releasing more specific rules?

Peter Miller

I think, so first of all, they were not on that list of names that came out yesterday. And I think that generally speaking, we would prefer some strong regulation and understanding of exactly where the rules lie and then be able to compete on a level playing field. CBD is—there's still a huge opportunity for growth for the whole industry. There's no doubt it's becoming more competitive every day, and ultimately the lower barriers to entry and combined with the opportunity brings a tonne of people into the mix. I think we, as well as most of the other folks trying to do things the right way, would appreciate strong regulation and guidance from the FDA. So we'll see. I think that goes across the board for all the categories we operate in, but certainly, as you've identified, CBD is going to get more scrutiny and guidance across the board.

Bobby Burleson

Okay. Great. And you guys are doing pretty well in terms of market share in certain states. Gummies, number three in Nevada; number two distillate in California with Bakked; O.penVAPE, obviously, you're dominating in Colorado. What's the opportunity for sort of cross-pollinating across states with those brands? And where do you see the most upside in terms of maybe picking up share where you don't have significant share in a given state for a given product line?

Peter Miller

Sure. So taking these brands to other states is absolutely something we're focused on doing and that we've done. But we see taking the brands to other states that are more emerging markets for us, like Florida, is best done with a strong partner. We're seeing kind of quarter over quarter in the peer group that some of the more regionally focused names are executing incredibly well. And partnering with groups like that allows us to, at worst, on a cash-neutral basis, get brands into market and start testing the feedback and response.

I think, though, the opportunity within our core markets in the short term is even bigger because of what I was mentioning before. You have clear regulation. You know where you stand. And the largest category of them all, flower, we haven't made a strong push into yet. So with the deal we announced with Cookies for Colorado, we see that as sort of just the tip of the spear of what we're going to do in flower.

And it's the same stores that carry all of our other products that are selling all of the flower, and now we have a brand that's in high demand and that they're very keen to get access to.

So we take the same supply chain relationships that we use to purchase inputs for our other products, expand the relationship with those suppliers to also include collaboration on premium flower SKUs, and then so we were bolstering relationships from the supply side, then we're bolstering relationships on the retail side because the stores want that brand, and that gives us a conversation about our other flower brands, Strain Hunters and Green House Seed Co., for example, which also sit at the premium end. But we haven't even touched value flower, and we've seen other groups do extremely well in value flower when they've had the right distribution relationships. So I think organic growth in core markets, just through categories that we're not currently participating in, represents huge growth.

And then separate to flower, you have certain concentrates subcategories that we don't compete in. Now they're not as massive as flower. When you're talking about live rosin, live resins, solventless, you're talking about very—much smaller subcategories on a relative basis, but you're talking about subcategories experiencing triple digit year-over-year growth in a lot of cases. And when you're talking about these ultra-premium concentrates, the process to make them is a lot more artisanal, which doesn't allow for the same level of scale, but it also defends against price fighting because you are talking about a process, for example, with fresh frozen solventless that has to go through a handful of steps that do require as much art as science.

So we're doing some really interesting things with that product line and putting them in different pieces of hardware that we sell, and we're really excited about what that looks like. So that'll be high margin, smaller growth in absolute terms, but flower represents solid margin but very significant growth in absolute terms.

Bobby Burleson

Okay. Great. Thanks. You did touch on Florida and Trulieve, and they're obviously doing very well in the state and you guys are rolling out your partnership there. How should we think about the linearity of that rollout? Are you guys able to go statewide right away? Or are there several step functions involved?

Peter Miller

Ultimately, it's a strategy that we have to set with Trulieve about what's strategic, which stores we launch with, at what point in time. So I don't think it's as simple as one-to-one they open a store that carries X units of product and we proportionately represent the same number in each place, because we will have different brands that might resonate with different socioeconomic sort of demographics.

Similarly to any sort of retail environment, Trulieve is opening, I believe, their 40th store right now, and those stores exist in different neighbourhoods, different locations, and I think there's different consumer behaviours in each of those places. You can use alcohol analogies or other industries where certain premium labels or certain value labels just do very differently in different places. So it's not one-to-one, but their growth is ultimately our growth as well in that state, and we're really proud to be growing with them in that market.

Bobby Burleson

Great. Thanks.

Peter Miller

Thank you.

Operator

Your next question comes from the line of Paul Piotrowski of M Partners. Your line is open.

Paul Piotrowski — M Partners

Hey, guys. Good morning.

Peter Miller

Morning, Paul.

Paul Piotrowski

Just a quick question on NSH. Can you give an update on how that's going?

Peter Miller

Sure. Yeah. So NSH, their primary assets are a manufacturing facility in California, one in Oregon, and then a handful of minority shareholdings. And ultimately, that is a more complicated set of financials that have to come up to public company reporting standards because you have assets that were live during a transition from one regulatory program to another, in the case of California particularly. So we're still working through making sure that we have every single nut and bolt understood, accounted for, and are in a position to exercise with everything in mind that comes from that process.

Paul Piotrowski

So can you give a timeline?

Peter Miller

We're not guiding specifically on that right now because unlike ACG where we have a very short-term line of sight on exactly the steps, there's still work to be done in terms of making sure the financials are where they need to be.

Paul Piotrowski

Okay. And then any updates on what you intend to roll out with in Canada in December?

Peter Miller

Yup. We initially showed the Firefly Mini and the O.pen line of 510 cartridges and the Bakked Dabaratus, as well as some Green House Seed Co. and Strain Hunters flower SKUs. So it was pretty thrilling to see a live and compliant version of each of those products in the facility get developed and start building inventory over the past couple of months. And I wish I could be there right now as the OCS takes a look with their QA folks. But those are the products we're initially targeting, and I think they're set up for success due just to simplicity and what we know the market demand is for them elsewhere.

Paul Piotrowski

Okay. All right. Yeah. That's it for me. Thanks.

Peter Miller

Thank you.

Operator

And again, ladies and gentlemen, to ask a question, please press *, then 1 on your telephone keypad.

Peter Miller

Okay. If there's no more questions, thank you very much, everybody. We're happy to make ourselves available to anybody who thinks of a question later or just wants to generally reach out with any questions, comments, et cetera. Thanks, everybody.

Operator

Ladies and gentlemen, this concludes today's conference call. Thank you for your participation. You may now disconnect.