

29-Oct-2014

Cirrus Logic, Inc. (CRUS)

Q2 2015 Earnings Call

CORPORATE PARTICIPANTS

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Chief Financial Officer, Vice President of Finance and Treasurer

Chelsea Heffernan
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Jason P. Rhode
President and Chief Executive Officer

OTHER PARTICIPANTS

Erik P. Rasmussen
Stifel, Nicolaus & Co., Inc.

Christopher J. Longiaru
Sidoti & Co. LLC

Christopher Hemmelgarn
Barclays Capital, Inc.

Tom Sepenzis
Northland Securities, Inc.

Shannon Richter
Feltl and Company

MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon. My name is Chris, and I will be your conference operator today. Welcome to the Cirrus Logic second quarter fiscal year 2015 financial results Q&A session. At this time, all participants are in a listen-only mode. After a brief statement, we will open up the call for questions from analysts. Instructions for queuing up will be provided at that time. As a reminder, this conference call is being recorded for replay purposes.

I would now like to turn the conference call over to Mr. Thurman Case, Chief Financial Officer. Mr. Case, you may begin.

Thurman K. Case
Chief Financial Officer, Vice President of Finance and Treasurer

Thank you and good afternoon. Joining me on today's call is Jason Rhode, Cirrus Logic's President and Chief Executive Officer, and Chelsea Heffernan, Manager of Investor Relations.

Today we announced our financial results for the second quarter fiscal year 2015 at approximately 4 p.m. Eastern time. The Shareholder Letter discussing our financial results, the earnings press release including a reconciliation of non-GAAP financial information to the most directly comparable GAAP information, along with the webcast of this Q&A session are all available at the company's Investor Relations website at investor.cirrus.com.

This call will feature questions from the analysts covering our company, as well as questions submitted to us via email at investor.relations@cirrus.com.

Please note that during this session we may make projections and other forward-looking statements that are subject to risks and uncertainties that may cause actual results to differ materially from projections. By providing this information, the company undertakes no obligation to update or revise any projections or forward-looking statements, whether as a result of new developments or otherwise.

Please refer to the press release issued today, which is available on the Cirrus Logic website, and the latest Form 10-K and 10-Q, as well as other corporate filings made with the Securities and Exchange Commission for additional discussion of risk factors that could cause actual results to differ materially from current expectations.

Now I'd like to turn the call over to Jason Rhode, our President and Chief Executive Officer. Jason?

Jason P. Rhode

President and Chief Executive Officer

Thank you, Thurman. Before we begin taking questions, I'd like to make a few comments. For a detailed account of our financial results, please read the Shareholder Letter posted on our Investor Relations website.

Q2 was an outstanding quarter for Cirrus Logic, as we delivered revenue of \$210.2 million, which included approximately five weeks of contribution from the Wolfson acquisition.

GAAP EPS for the September quarter was \$0.01, and non-GAAP EPS was \$0.68. GAAP results reflect \$32.3 million in acquisition-related charges. On a standalone basis, Cirrus Logic generated \$197.2 million in revenue, exceeding expectations as strong demand for portable audio products was fueled by shipments ramping in several new flagship smartphones.

The strategic rationale for the acquisition was primarily driven by the fundamental value of Wolfson's technology, skilled engineering teams, and the potential for the combined company to capitalize on additional opportunities. The acquisition accelerates Cirrus Logic's strategic roadmap; further strengthens our technology portfolio with the addition of MEMS microphones, advanced DSP technology, and extensive software capabilities, particularly in the Android ecosystem; and expands our development capacity and customer base.

As the only IC supplier of a solution that spans the complete audio signal chain from capture to playback, Cirrus Logic is now well positioned as a market leader, with a broad portfolio of custom and general market products shipping in many Tier 1 flagship devices today, including five of the top 10 global smartphone OEMs. The combined company is leveraging our unparalleled expertise in analog and mixed-signal technology, comprehensive software capabilities, and world-class engineering teams to drive continued innovation in the rapidly changing audio market.

As the value placed on audio and voice technology continues to increase, there is an opportunity to drive revenue growth over the next several years through the addition of new customers and expanding content with existing customers.

Before we begin the Q&A, I would also like to note that, while we understand there is intense interest related to our largest customer, in accordance with our policy we do not discuss specifics about our business relationship.

Operator, we're now ready to take questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Your first question is from Tore Svanberg with Stifel. Your line is open.

Erik P. Rasmussen
Stifel, Nicolaus & Co., Inc.

Q

Yeah, hi, guys. This is Erik calling in for Tore.

Jason P. Rhode
President and Chief Executive Officer

A

Hi, Erik.

Erik P. Rasmussen
Stifel, Nicolaus & Co., Inc.

Q

I wanted to get to your current quarter. It looks like your largest customer is 73%, so – and you'd mentioned a lot of traction in – with other OEMs. Is it safe to assume that that number was around – approaching double-digit or \$10 million, and was that in line with your expectations?

Jason P. Rhode
President and Chief Executive Officer

A

I'm sorry, I'm not 100% sure I understand the question. So I want to make sure I answer the right one.

Erik P. Rasmussen
Stifel, Nicolaus & Co., Inc.

Q

Oh, sure. Yeah. So your largest customer was 73%, and you're kind of breaking out your business now of portable and non-portable, and if we look at that, I'm assuming your largest customer goes into the portable bucket, and that was about \$153 million, \$154 million. And your portable audio was \$164 million. Should we assume that the traction you were talking about with other customers, several flagship platforms, did that approach the double-digit amount in the quarter in revenue?

Jason P. Rhode
President and Chief Executive Officer

A

Well, it's a little more complicated than that because the portable versus non-portable isn't really split by customers, because for example computers would be in non-portable.

Erik P. Rasmussen
Stifel, Nicolaus & Co., Inc.

Q

Okay. But safe to assume you had nice growth with these other platforms exclusive of Wolfson?

Jason P. Rhode
President and Chief Executive Officer

A

Yeah, we're seeing very good things out of some of the other folks in the mobile space. You know, I would characterize that business as a little bit more typical of the analog and mixed-signal market, where especially the

cell phone market in the Chinese market is a lot more opportunistic. You know, you're going to win one model and then not win the next model necessarily. It's difficult to create a dynasty in that market, no pun intended.

But we're very comfortable with how we're doing there. We see a lot of demand for the ability to differentiate in some of these smaller accounts. A lot of times there, opportunities to differentiate as part of the core chip set are very limited. And so they're looking to things like louder speakers or karaoke functions or very high signal-to-noise-ratio performance, for example. Sometimes to a surprising extent, we're seeing that start to drive demand in some of these other accounts. So we're really optimistic about what the future holds for us there.

Erik P. Rasmussen

Stifel, Nicolaus & Co., Inc.

Q

Thank you. And then on your – based on your Q4 outlook, can you comment on what were some of the specific areas where – maybe elaborate what the negative market factors are that's causing the steep declines in their business?

Jason P. Rhode

President and Chief Executive Officer

A

So for the December quarter – I mean, I don't think it's a surprise to anyone that over the last six months the outlook for let's call it the high end of the Android handset space is significantly more muted than people would've expected three or certainly six months ago. So I think that's a large part of it. I think that the Wolfson team had done and now as part of Cirrus continues to do a great job of winning the designs that they expected to win. And then the kind of secondary factors that indicate how much – or that determine how much revenue we'll get off of that are obviously how successful are those models in the end market and then ultimately, in some cases where a handset manufacturer might have multiple designs for the same handset, it's a question of how much of that split do we get versus some other solution. And that is unfortunately – neither of those two things are in our control.

So, like I say, I think the UK team have done a great job of winning the designs that they said they were going to win and positioning us very well to continue to do that in the future and also strategically try to address at least the split within each model that we do get, trying to hopefully steer as much of it our way as possible when there is a lever for us to pull on that.

Erik P. Rasmussen

Stifel, Nicolaus & Co., Inc.

Q

Okay. Thank you. That's helpful. And then maybe just finally, one last question and I'll jump back in the queue. Sounds like – that you're not going to be – hit your accretion target for this quarter. You've seen a kind of a step up in R&D, but when do you expect this deal to get accretive? I know you're facing some kind of revenue headwinds there as well, so any help would be appreciated.

Jason P. Rhode

President and Chief Executive Officer

A

Yeah. Well, we – I mean, we only guide out for the current quarter, and I really – I think longer term and after the December quarter, the right way to model the company is as one company with the revenue breakout that we've given. Certainly the reasons for the short-term lack of accretion, largely as we've gone into previously there, is related to the revenue in the high end of the Android space. Our crystal ball is not so good as to be able to call the revenue further out; otherwise we'd give guidance further out.

So it's really a matter of when the revenue shows up. But the right way to think about the company is as one company going forward. We've already merged R&D. We've moved different programs around, so things that as separate companies might have got done in the UK, we're looking at having some of those done in Austin. Some of the things that we were doing in Austin are already being done in the UK. So it gets to a point where the waters in terms of what would have been in terms of accretion on a standalone basis start to not have as much meaning as they might have otherwise.

So our goal, the reason we did the acquisition, is we think it positions us to grow faster the combined company in the long term better than we would have been able to do as two standalone companies. And I think that's the thing you ought to be looking for as far as the proof point of whether the acquisition was worthwhile in the long run.

Erik P. Rasmussen
Stifel, Nicolaus & Co., Inc.

Q

Thank you. Good luck.

Jason P. Rhode
President and Chief Executive Officer

A

Thanks.

Operator: Your next question is from Blayne Curtis with Barclays. Your line is open.

Christopher Hemmelgarn
Barclays Capital, Inc.

Q

Hi. This is Chris on for Blayne. Just wanted to – if you could comment a little more on kind of the gross margin direction you guys are seeing, exactly what's driving that lower, just kind of general impacts there.

Jason P. Rhode
President and Chief Executive Officer

A

Yeah. Sure, I mean just first, so there's not any confusion on it, in the guidance we've given there's approximately 200 basis points' worth of impact to the GAAP number based on the fair value write-up of the inventory we acquired from Wolfson, so that's really more of an accounting item than it is anything meaningful relative to the business. And then the December quarter, of course, is our seasonally largest order of portable audio. Portable runs lower on average than the rest of the product lines of the company. So the fact that in our largest quarter of portable, we're remaining consistent with the long-term guidance that we've given of mid-40s, I think is actually really good news there, because it's a pretty remarkable step up in portable going from the September to December quarter.

Christopher Hemmelgarn
Barclays Capital, Inc.

Q

Got you. That's very helpful. Thanks. I also just caught some new language saying that you guys are shipping smart CODECs today. I was just curious if those are some of the 55 nanometer parts you've been working on and if you could comment at all just about how that launch is going in those new products and where they're shipping today if they are, or when you expect them to start shipping if they're not.

Jason P. Rhode
President and Chief Executive Officer

A

Sure. I mean, I suppose it's a little bit of semantics. When we say smart CODEC or the Wolfson team previously referred to as audio hubs, what we mean is a DSP that's integrated with a CODEC. The UK team is shipping a variety of those products today in 65 nanometer. 55 is basically an optical shrink of that. We expect from the Cirrus side of things to start shipping some of the 55 nanometer stuff that we've developed in calendar 2015. And the UK team to continue to develop – or continue to ship their 65 nanometer and then going forward start shipping 55 nanometer in 2015 as well. So – now, whether we've – we've certainly shipped a lot of other products historically that one could categorize as smart CODEC as well, I suppose, but they're more in a category that we don't talk about so much, so.

Christopher Hemmelgarn

Barclays Capital, Inc.

Q

Thanks very much, and congrats on the good quarter.

Jason P. Rhode

President and Chief Executive Officer

A

Thanks. Appreciate it.

Operator: [Operator Instructions] Your next question is from Jeff Schreiner with Feltl and Co. Your line is open.

Shannon Richter

Feltl and Company

Q

Yes. This is Shannon Richter on for Jeff Schreiner. Just a couple questions here. When giving the guidance for December, can you break out what part of that would be Wolfson revenue?

Jason P. Rhode

President and Chief Executive Officer

A

Yeah, we're not breaking that out at this time. We'll report on that at the end of the quarter.

Shannon Richter

Feltl and Company

Q

Okay. And then -

Jason P. Rhode

President and Chief Executive Officer

A

I would characterize it, though, as kind of the rough guidance that we've given in the Shareholder Letter, though. Certainly it's more muted than what we expected to see when we did the acquisition. We're very comfortable with the strategic rationale for the acquisition, and as we talked about with one of the previous questions, the high end of the Android space is probably a little bit more restrained at this point than what it was expected to do three to six months ago.

But the team's doing what they need to do to continue to grow that business, win the sockets. And the good news again is we're doing pretty well with already five of the top 10 smartphone manufacturers there, and certainly within the smartphone space, sometimes if one of them's not doing so well, it's because another one is doing real well. And since we're positioned pretty well with a wide variety of them, that actually works out to be net-net good news overall for the company.

Shannon Richter

Feltl and Company

Q

Thank you for the clarity on that. And then just one final question. Can you give us – or give me the remaining deferred tax assets?

Thurman K. Case

Chief Financial Officer, Vice President of Finance and Treasurer

A

Well, at this time basically the way we're speaking to it is that we expect that the deferred tax assets and the tax credits will be basically completely depleted by the end of this year. And, again, we expect our effective tax rate to be about 4% or less in the next couple of quarters.

Shannon Richter

Feltl and Company

Q

Perfect. Thank you so much.

Operator: Your next question is from Christopher Longiaru from Sidoti & Company. Your line is open.

Christopher J. Longiaru

Sidoti & Co. LLC

Q

Hey, guys. My congrats on the good quarter.

Jason P. Rhode

President and Chief Executive Officer

A

Thanks, Chris.

Christopher J. Longiaru

Sidoti & Co. LLC

Q

So I jumped in late, so I apologize if I'm asking something again. I'm curious as to how the audio products that you're moving into, and you're gaining more and more traction there, compare relatively from a gross margin perspective on the majority of what you're selling now?

Jason P. Rhode

President and Chief Executive Officer

A

Well, we think the portable market, the reason that we came up with our long-term outlook of being in the mid-40s, we think that's a reasonable place for a portable audio business to sit. That's a reasonable place for things that are shipping in high volume in the handsets to sit. And thankfully we've got a pretty efficient business model that actually works out well and ties in to our long-term goal of 20% operating. So we want to grow revenue, and we want to do it in a way that is supportive of our 20% op margin target. We think the gross margins that we're seeing on the new stuff that we're developing is largely supportive of that goal, and so we're pretty pleased with that.

Christopher J. Longiaru

Sidoti & Co. LLC

Q

Okay. And so basically as you move forward and you infiltrate this market, your long-term model looks – excluding, obviously, the acquisition-related costs – looks pretty similar to what you are doing right now from a gross margin perspective?

Jason P. Rhode
President and Chief Executive Officer

A

Right. Yeah -

Christopher J. Longiaru
Sidoti & Co. LLC

Q

Yeah.

Jason P. Rhode
President and Chief Executive Officer

A

- we're just still very comfortable with that mid-40s percent that we're in.

Christopher J. Longiaru
Sidoti & Co. LLC

Q

Okay. And - oh, yeah, sorry - and my other question has to do with - so I know you don't want to give guidance on this too far out, but have you made the decisions on what you're going to move to Wolfson and what you're going to move from Wolfson to Cirrus at this point? Are you still working through those decisions?

Jason P. Rhode
President and Chief Executive Officer

A

Well, I mean, that's always a work in progress. We've got two very similar teams with remarkably complementary skill sets. The Cirrus team has really made a name for ourselves in executing silicon in a way that is pretty much unparalleled in our portion of the space, as far as I can tell. And so we're obviously trying to move that methodology over into the UK side. The UK team was clearly ahead in terms of software capabilities, particularly in the Android space. So we're trying to utilize that wherever we can across the company.

In terms of what chips are getting developed where, I think it's well understood inside the company now what things have been moved around a little bit. But we'll definitely go through a period of a time where it's a little bit of an optimization exercise of where do we have engineers freeing up versus what's the next great program that we can staff, and then kind of matching those resources up with the next great program.

So it'll be a little bit of a work in progress for a while, but I think schematically it's largely settled out. And I will take the opportunity to give a shout out to the teams that were involved. This is an area where acquisitions can go very sideways and companies get in these culture wars, and I think because we came into this acquisition with almost the exact same vision for where we wanted our audio products to go and what our roadmap looked like, that we got to skip that whole step that is usually a big contentious - or can be a big contentious issue, and the teams really got right to work. And just, since the goal was shared, all we needed to do was rationalize the two plans to achieve the goal.

And they've made remarkable progress in a much shorter amount of time than I would have expected it to take, and they're already off and running and making good progress and keeping our customers happy, which is obviously ultimately the big goal. So I'm really, really pleased with how all of that has gone.

Christopher J. Longiaru
Sidoti & Co. LLC

Q

Okay. And my last question is a lot of talk, rightfully so, about your audio business, portable audio business. There's been a lot of work on the LED front, and we haven't really heard much of an update there. Can you give us an update as to where that is and what your expectations are at this point for that business?

Jason P. Rhode

President and Chief Executive Officer

A

Well, I think we kind of positioned it over the last couple of calls that there are certainly good opportunities in that market. We developed some remarkable technology that solves real problems. We're selling the products. But strategically the way we had to look at it back in the spring, there wasn't any means possible where we could staff all of our opportunities as a company. And so one of the more challenging aspects of managing this kind of company is that we're required to staff our best opportunities and not opportunities that are merely good.

And even post the Wolfson acquisition, both companies separately – neither of us could figure out how to get everything done in audio that we wanted to do. And it turns out even with the efficiencies post the acquisition this is just such a remarkable time in the audio and voice space that even combining the two teams, taking advantage of the R&D efficiencies that that gains, where we don't have to duplicate each other's product lines – we can put the team on things that are additive and parallel – we're still not able to satisfy everything that we want to go do in audio. And the audio opportunities are just significantly larger, significantly nearer term, and much more in our wheelhouse than what we were looking at in LED. So we're interested in that technology. We're still selling the products. We're keeping an eye on whether there are other ways to monetize it, whether there's any kind of change in the landscape. But for now you should think about us as an audio company. That's certainly where our best opportunities lie.

Christopher J. Longiaru

Sidoti & Co. LLC

Q

Great. I'll jump out with that. Thank you, guys.

Jason P. Rhode

President and Chief Executive Officer

A

Thanks, Chris.

Operator: Your next question is from Tom Sepenzis with Northland Capital Management. Your line is open.

Tom Sepenzis

Northland Securities, Inc.

Q

Hi, guys. Thanks for taking my questions. Can you give us any kind of guidance in terms of other income and your interest expense moving forward?

Thurman K. Case

Chief Financial Officer, Vice President of Finance and Treasurer

A

On interest expense, we would expect that over the next couple of quarters to be between \$1 million and \$1.5 million a quarter, and that'll reduce further as we go into the next year as we pay down the debt facility.

Tom Sepenzis

Northland Securities, Inc.

Q

And other income?

Thurman K. Case

Chief Financial Officer, Vice President of Finance and Treasurer

A

Well, interest expense is – interest income and the other income is going to be very small since we do not have a large cash balance.

Tom Sepenzis

Northland Securities, Inc.

Q

So the \$12 million in the September quarter is mainly one-time events?

Thurman K. Case

Chief Financial Officer, Vice President of Finance and Treasurer

A

Yes.

Tom Sepenzis

Northland Securities, Inc.

Q

Great. Thank you. And you mentioned the tax rate for the next couple quarters of about 4%. Do you have any idea what that might be looking out [ph] a year? (22:41)

Thurman K. Case

Chief Financial Officer, Vice President of Finance and Treasurer

A

Well, if you look at – looking into FY 2016 we would really expect a combined corporate tax rate of somewhere along the line of 30% average for the year. It's going to be a little higher at the beginning of the year, the first couple of quarters of the fiscal year, and a little bit lower on the second half of the fiscal year. And really as we begin to generate more revenue and income offshore, when you look at FY 2017 and beyond, we would expect that tax rate to lower further.

Tom Sepenzis

Northland Securities, Inc.

Q

Great, thank you. And can you talk a little bit about the non-portable segment and exactly what is in there now with the combined company?

Jason P. Rhode

President and Chief Executive Officer

A

Sure. Yeah, there's a bit of detail on that in the letter, but with things like computer, automotive, home theater, obviously some of the legacy business from years ago, lighting, power meters, seismic, stuff like that. So it's – but the audio portion of that is probably the most – in the short term is probably the most interesting of it. And we'll try to provide a little bit of color as we're talking about what is and isn't doing well. But it felt like that was a better way to break out the revenue in a way that was more useful.

Tom Sepenzis

Northland Securities, Inc.

Q

Yeah, no, thank you. I appreciate it. Congratulations on the quarter.

Jason P. Rhode

President and Chief Executive Officer

A

Thanks. We appreciate it.

Operator: [Operator Instructions] You have an additional question from the line of Tore Svanberg with Stifel. Your line is open.

Erik P. Rasmussen
Stifel, Nicolaus & Co., Inc.

Q

Yeah, thanks for taking my follow-up here. I know you mentioned in the Shareholder Letter automotive is one of those targeted areas, wearables as well. Sounds like wearables was highlighted a little bit more. But there seems to be a lot of buzz in automotive around the handset OEMs going after the automotive market. Wanted to get your thoughts on that, especially as it relates to systems like your largest customer's CarPlay and how you see automotive opportunity for Cirrus?

Jason P. Rhode
President and Chief Executive Officer

A

Sure. I appreciate the question. You mentioned the two categories, wearables and automotive, that I think are the most direct beneficiaries of all the investment we're making in the handset space, because handsets are neat in that that's such a high-volume market. There's so much demand for new features, and they get refreshed pretty much every year if not more frequently. So that you can really get a lot of cycles of learning and perfect these technologies, and they are also largely are self-contained.

But those exact same technologies, whether it's always-on voice or voice wake or improving the signal-to-noise environment so that speech recognition works better, or any number of different technologies, those are things that play directly into wearables and automotive. In automotive, I think it's pretty much every one of us has had the experience of taking the latest cutting-edge smartphone and putting it in a fairly new late-model car, both of which work perfectly fine on their own, and having a fairly disappointing audio or voice experience as a result of putting the two together. That something that we'd really like to see addressed. It's a great place for a lot of the technologies that we can bring to bear to all come together, whether it's noise cancellation, noise suppression, voice wake, always-on voice. We see a home for a lot of those functions in automotive.

And I think the other nice property that it's got going for it, much like in the handsets, frankly, is that some of these features that used to be reserved for the very high end of the market, there's so much demand for them, and frankly the customers that really use them are not necessarily at the highest end of the user base. And so these features are migrating not only to new customers, but they're migrating down each customer's product line into the mid-tier and lower-end models.

So we see in markets like automotive and smartphone where things have some potential in terms of overall units to grow, we see the opportunity for audio and voice to grow more rapidly than that as the features move down the product lines. So we're very bullish on the long-term opportunities for the kinds of things that we're very good at to really gain traction in all those spaces.

Erik P. Rasmussen
Stifel, Nicolaus & Co., Inc.

Q

Thank you very much for that. Good luck. Thank you.

Jason P. Rhode
President and Chief Executive Officer

A

Thanks. Appreciate it.

Operator: [Operator Instructions] There are no further questions at this time. I'll now turn the call over to Ms. Heffernan.

Chelsea Heffernan

Investor Relations Manager, Cirrus Logic, Inc.

Thank you, operator. The question submitted via email this afternoon were answered during the Q&A. I will now turn the call back to Jason.

Jason P. Rhode

President and Chief Executive Officer

Thank you, Chelsea. In summary, Q2 was a great quarter for Cirrus Logic, as we delivered a strong sequential revenue growth and closed the acquisition of Wolfson. With a broad range of solutions spanning the audio signal chain from capture to playback, an innovative strategic roadmap, and a commitment to accelerating R&D investment in compelling programs, we believe we are well positioned to drive future growth opportunities.

Would also like to note, we will be attending the NASDAQ OMX Investor Program in London on December 3 and 4 and the Barclays Technology Conference in San Francisco on December 9.

If you have any questions that were not addressed today, you can submit them to us via the Ask the CEO section of our investor website. I'd like to thank everyone for participating today. Goodbye.

Operator: This concludes today's conference call. You may now disconnect.

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