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# Cirrus Logic, Inc. (CRUS)

Q3 2015 Earnings Call

## CORPORATE PARTICIPANTS

Thurman K. Case

*Chief Financial Officer, Vice President of Finance and Treasurer*

Jason P. Rhode

*President, Chief Executive Officer & Director*

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## OTHER PARTICIPANTS

Christopher Hemmelgam

*Barclays Capital, Inc.*

Erik P. Rasmussen

*Stifel, Nicolaus & Co., Inc.*

Christopher Longiaru

*Sidoti & Co. LLC*

Tom Sepenzis

*Northland Securities, Inc.*

Tore E. Svanberg

*Stifel, Nicolaus & Co., Inc.*

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## MANAGEMENT DISCUSSION SECTION

**Operator:** Welcome to the Cirrus Logic Third 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 queueing 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.

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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, our Manager of Investor Relations.

Today, we announced our financial results for the third 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](http://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](mailto: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, Chief Executive Officer & Director*

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.

We are very pleased with Cirrus Logic's financial results for the December quarter as we delivered year-over-year and sequential revenue growth. Revenue for the quarter exceeded our expectations at \$298.6 million due to the increased sales of our portable audio products. Operating profit for the quarter was 15% GAAP and 23% non-GAAP. Earnings per share were \$0.35 GAAP and \$0.97 non-GAAP.

The company has invested a significant amount of R&D dollars in engineering resources over the past several years to target opportunities in the rapidly emerging audio and voice markets. We began a multi-year process to transition a large portion of our product portfolio to 55-nanometer, including the fundamental redesign of some of our intellectual property. These products have been well-received by customers and we expect volume shipments to begin in FY 2016. We believe the additional functionality, the decrease in power consumption and the sizable increase in memory and digital signal processing capability enabled by our smart codecs will allow the company to command higher ASPs for these next-generation products versus their 180-nanometer counterparts.

Despite the rapid growth of our engineering teams, the opportunities for our innovative technology have outpaced our ability to pursue them organically. Through the acquisition of Acoustic Technologies in 2013 and Wolfson Microelectronics in 2014, the company accelerated our strategic roadmap and strengthened our product portfolio with additional smart codecs as well as MEMS microphones and best-in-class software. We are very excited about the prospects at Cirrus Logic going forward.

The introduction of new products targeting the audio and voice market that have been developed by both Cirrus Logic and Wolfson are driving the company's expectation for growth in FY 2016. We expect to benefit in FY 2017 and beyond from further product introductions based on the combined company's 55-nanometer platform and the cross sale of components such as our highly advanced amplifiers and MEMS microphones into existing smart codec customers.

Before we begin the Q&A, I would also like to note that while we understand there is intense interest related to our latest 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:** [Operator Instructions] Your first question comes from the line of Blayne Curtis from Barclays. Your line is open.

Christopher Hemmelgarn

*Barclays Capital, Inc.*

Q

Hi. This is Chris Hemmelgarn on for Blayne. Thanks very much for taking the question and congrats on the strong quarter and guidance.

Jason P. Rhode

*President, Chief Executive Officer & Director*

A

Thanks, Chris

Christopher Hemmelgarn

*Barclays Capital, Inc.*

Q

Given the things should we be going pretty well with your largest customer, I guess I'll take a look at the Android ecosystem instead, 65-nanometer smart codec shipping there. I was hoping you could talk a little bit about opportunities in Android with that part and whether or not you expect to see any traction in that ecosystem with the 55-nanometer party you guys have upcoming [indiscernible] (05:23)

Jason P. Rhode

*President, Chief Executive Officer & Director*

A

So we've got some color on that in the Shareholder Letter, and then also just to highlight, the Wolfson team had migrated their products down the process curve significantly before Cirrus did. So they actually targeted 65-nanometer instead of 55-nanometer because 55-nanometer wasn't ready yet. As it happens, 55-nanometer is just an optical shrink of 65-nanometer. So they're pretty closely related. So the Wolfson team had done a great job of landing their first smart codec socket last year. We expect to continue that progress this year. There's new production introductions, first in 65-nanometer and then a little bit further, not a whole lot further, but a little bit further out in the year in 55-nanometer from the products that are, I guess, of the Wolfson DNA. So we expect very good things there. We expect to grow our share in Android meaningfully this year, and that's part of what's contributing to the upside this quarter as well.

Christopher Hemmelgarn

*Barclays Capital, Inc.*

Q

That's great. Thank you very much. Just a quick follow-up. I guess kind of more broadly and longer term, in the advent of voice, on voice one of the features you talked about adding, what type of roadmap do you see beyond this year for further advances in processing power, the mics you're developing and just some of the other general features supporting always-on voice.

Jason P. Rhode

*President, Chief Executive Officer & Director*

A

Sure. It's – always-on voice is actually the kind of the neat, best case convergence of really everything that we're very good at. So very low power, combines analog and digital signal processing capabilities, now with the

opportunity to incorporate the Wolfson microphones and potentially optimize those over the coming years, optimize those in tandem with the codec, we think allows us to provide an even better performing, better power consumption, better experience for the user overall. So we're very excited about continuing to press on always-on voice and supporting that in a variety of different ways. It means lots of different things to different customers, it means different things in devices that, for example, don't have an applications processor. So as the ecosystem in the homes gets a little more interesting, lots of companies are targeting that space. It's a very good opportunity for us.

So always-on voice, the neat thing about it is there's no such thing as low enough power. No matter how low we get it, customers are asking us to cut it in half. And on top of that ideally there's lots of customers that have gone from talking about doing it with one microphone to wanting to have several microphones, for example, for beam forming. So there's a lot of dimensions left to innovate on in the AoV space itself. But further, the whole suite of software capabilities that you can find in the investor presentation on the website highlighting everything from noise suppression, wind noise, to record specific features, audio zoom, all manner of different things that people want to support all in parallel on the same device really increases the [ph] case (08:32) to be made for smart codecs in general, and we think sets up to just create a number of years worth of really good opportunities for us that are right in the sweet spot of what we're good at.

Christopher Hemmelgarn  
*Barclays Capital, Inc.*

Q

Thanks very much for the color there and congrats again on the quarter.

Jason P. Rhode  
*President, Chief Executive Officer & Director*

A

Thanks. Appreciate it.

**Operator:** Your next question comes from the line of Erik Rasmussen from Stifel. Your line is open.

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

Q

Yeah. Guys, very nice results and guide. I just want to follow-up on some of the comments you made in your Shareholder Letter in the past question. As it relates to Wolfson, it appears that this business did about \$120 million in revenues last year. And that's down from the prior two years I think that they did about \$180 million. But you had indicated in your outlook that this business would be up significantly in the March quarter. I just want to get your thoughts, your expectations for calendar 2015. Do you think you can reach that prior revenue number, or close to it again? Obviously, this was probably the low watermark this year for that business.

Jason P. Rhode  
*President, Chief Executive Officer & Director*

A

I think our – no matter how you look at it, it looks like our timing was pretty remarkable in pulling that off. Rumors of our business acumen might have been a little bit down last quarter. We're very excited about the outlook that they've got this year. They had a tough perfect storm of things that hit them last year in terms of market share and as well the success of some of their customers. We don't get to control that second aspect, but we certainly have an opportunity to improve our share in their existing customers.

The team have done a great job developing products. So we do see a great outlook for the current quarter. We try not to get real specific beyond the current quarter, but we expect significant growth from them for FY 2016 as well.

So we are as pleased as could possibly be with that acquisition. The team has been fantastic. The things that we expected to have happen in 2015 and FY 2016 are happening in a lot of ways. I look at it, it's better than what I was thinking strategically would actually happen this early in the tenure of having that deal done. So we're very pleased with it.

Erik P. Rasmussen

*Stifel, Nicolaus & Co., Inc.*

Q

Thanks for the color on that. The IoT space continues to gain a lot of momentum, I know coming out of CES again this year, wearables segment was very strong. And I think you indicated a little bit in your Shareholder Letter. How do you see the wearables segment, though, opportunity for Cirrus? What sort of content or technology you're targeting? How big of an opportunity could this be for you guys? Maybe just some thoughts there.

Jason P. Rhode

*President, Chief Executive Officer & Director*

A

Well, we view meaningful dollars as being a ways away in that space, but as you said, it is clearly a very growing and very interesting market. It's not a big part of our – we've had – actually we've shipped in that space, either algorithms through the Acoustic Tech deal that are in a number of Bluetooth accessories as well as devices into kind of these first forays that our customers have made in that space. We don't expect that to do anything real meaningful in the short term, but it's a great home as we said in the Letter for a lot of the technologies that we've developed in phones and tablets, for example, the people want all those same functions and features in long run in wearables.

Now, as to content, the point that is important to make there is it really can vary a lot. In some applications, it can easily be nothing other than a digital microphone connected to a processor. It could be a microphone and a small amplifier, it could be a whole lot of our smart codecs where that device is the only processor in the system and provides the brand. So it really varies, we're seeing customers innovate in lots of different ways. I think it will be a while before we figure out what that market really wants to be. But it is really neat as now a lot of the things that we've all grown up thinking about are becoming real either because of the technology that's available or because some customers that actually have the wherewithal to do so are defragmenting the infrastructure in the home or at least have goals to do that so that it opens the door for a lot of innovation and individual products to take place in the home.

We should be able to talk to a lot more of our stuff than is currently done today. It is a very good opportunity for us to deploy our technology in these devices, typically if they're battery-powered, have very, very small batteries, so battery life matters a lot, power consumption matters a lot as well as us providing a voice interface, potentially music playback, et cetera. So we see it unfolding slowly over the next couple of years, but it's a great, great showcase for where our technology can go.

Erik P. Rasmussen

*Stifel, Nicolaus & Co., Inc.*

Q

Okay. Thank you. It's good explanation. And then just finally, maybe one for Thurman. On the tax rate, I know you run out of your DTAs and credits, possibly the March quarter. And then for fiscal 2016, you talked about a blended rate of 30%, and then lower in fiscal 2017. Just wanted to get your thoughts, though, on how much lower are we talking? Is there a certain range that you're targeting for fiscal 2017 on the tax line? Thanks so much.

Thurman K. Case

*Chief Financial Officer, Vice President of Finance and Treasurer*

A

Well, from a tax perspective, I don't think we actually target ranges. It's a process that we go through. And we do expect the tax rate to continue to decrease. So in FY 2017 and beyond that, I would note though, that in UK, the tax rate in UK is 20% and a significant amount of our revenue will be moving outside of the U.S. as we go into 2017 and 2018.

Erik P. Rasmussen

*Stifel, Nicolaus & Co., Inc.*

Q

Thank you very much.

**Operator:** Your next question comes from the line of Christopher Longiaru with Sidoti & Company. Your line is open.

Christopher Longiaru

*Sidoti & Co. LLC*

Q

Hey, guys. I'll echo my congratulations. Great quarter.

Jason P. Rhode

*President, Chief Executive Officer & Director*

A

Thanks. Appreciate it.

Christopher Longiaru

*Sidoti & Co. LLC*

Q

So my question has to do with – you talked about the relative unseasonal improvement in the Android business going into the March guide. Can you give us a little more color? Is that – in terms of the strength, is that more additional content with existing customers, or is that some of the new designs that you had been working on coming to fruition in terms of shipments? Can you give us a little bit of color there?

Jason P. Rhode

*President, Chief Executive Officer & Director*

A

Well, it's a combination, new product introduction as well as we expect to grow our share. So it's a good combination of things there.

Christopher Longiaru

*Sidoti & Co. LLC*

Q

And then just in terms of the integration of Wolfson. How much of that is left? How far along are you? Is there anything left that you intend to strip out? How do you see that going forward?

Jason P. Rhode

*President, Chief Executive Officer & Director*

A

Well, I mean, we're still working through the what I guess I would call the plumbing of the integration. I mean, we've – the management and organizational structures are done, the roadmaps are consolidated, engineers are working on what we expect them to be working on. So the things that remain really are related to, for example, SAP and merging the various different systems, et cetera. So there are some reductions that can happen as those things are completed. But given our revenue outlook, the hiring that we expect to do on the R&D side, we would certainly not expect our overall OpEx to go down at this point. I think we will be very challenged to have our R&D resources be able to keep up with our revenue growth this year.

Christopher Longiaru  
*Sidoti & Co. LLC*

Q

Okay. And the last thing I have is you paid down a good chunk of the debt. Is there a goal for how you expect to pay down that debt over time? Can you give us a little bit of an idea of how you're thinking about that?

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

A

Well, from a quarter-to-quarter basis, we look at the way we utilize cash, and certainly paying down the debt, I think we noted this last quarter, is a high priority for us. Again, I wouldn't say that we go into a quarter with a goal. We look at the amount that you pay down can't have an effect on certain covenants and how those affect your interest rate, and we'll manage that accordingly on a quarter-to-quarter basis.

Christopher Longiaru  
*Sidoti & Co. LLC*

Q

Okay. Thank you. I appreciate it. I'll jump out. Thanks, guys.

Jason P. Rhode  
*President, Chief Executive Officer & Director*

A

Thanks, Chris. Appreciate it.

**Operator:** [Operator Instructions] Your next question comes from the line of Tom Sepenzis from Northland Capital Markets. Your line is open.

Tom Sepenzis  
*Northland Securities, Inc.*

Q

Hi. And I will also echo my congratulations on the quarter and the guide. I'm just wondering if you see any further synergies in terms of [indiscernible] (17:59) operating expense now that you've had Wolfson in-house for a little while?

Jason P. Rhode  
*President, Chief Executive Officer & Director*

A

Well, I mean, I think that there, as I said in answer to the previous question, there's certainly the systems, et cetera, and things get merged, and we get rid out of those redundancies. There's costs that come out there, but they're probably more than offset by the growth that we would expect in our R&D resources as we try to scale those to keep up with the revenue. And additionally, the outlook – I would say that our outlook as a total company, and that is helped certainly by the success that we're having on the former Wolfson side of things, the outlook for the total company is better than we were expecting at the time of the acquisition. And so that's got a different set of plans in place at this point for how we're going to support that and how we're going to grow, different set of circumstances. So we adapt and improvise and go from there.

Tom Sepenzis  
*Northland Securities, Inc.*

Q

Thank you. And your inventories, you took down quite a bit here in the December quarter. Is that a level that you think will continue, or is that just because the seasonal – I guess, not really weak this March, but typical weakness in March?

Jason P. Rhode

*President, Chief Executive Officer & Director*

A

Yeah. Well, so I mean, obviously our revenue came in significantly higher than expected and that was in the face of strong demand, and that's what caused our inventory levels to go down. We don't think we will be in a position to get those back to where we really target within the next quarter. We're working very closely with our customers and suppliers to make sure we're doing a good job there, but, no, we do not expect inventory go back up this quarter. We would like to build more inventory out, we have to – it causes us a good kind of challenge to have to spend a lot of time on this type of problem.

Tom Sepenzis

*Northland Securities, Inc.*

Q

Excellent. And then lastly, just in terms of gross margin, looking ahead, do you see any major threats there, or is that something that we should be modeling incrementally higher as revenue goes up?

Jason P. Rhode

*President, Chief Executive Officer & Director*

A

Well, I mean we gave you the guide for the quarter and we'd maintain our model still in the mid -40% and we think that at our size and the market that we're targeting, that that's a reasonable level and some products are higher, some products are lower. But on the mix, obviously our target is high as possible. But we feel comfortable that the mid-40% is a reasonable range for us to expect.

Tom Sepenzis

*Northland Securities, Inc.*

Q

Excellent. Thank you very much. Appreciate it. Congratulations.

Jason P. Rhode

*President, Chief Executive Officer & Director*

A

Thank you.

**Operator:** Your next question comes from the line of Tore Svanberg from Stifel. Your line is open.

Tore E. Svanberg

*Stifel, Nicolaus & Co., Inc.*

Q

Yes. Thank you. Just some follow-ups, and very nice quarter by the way. I guess that the first question or first follow-up here is really on the sort of landing. What I mean by that, and then I know you don't typically give guidance more than a quarter out, but obviously you are tied to some strong product cycles. So just looking at the June quarter, should we assume the landing there to be relatively soft this year, or will it be a little bit harder because of the March quarter being better? I'm just trying to understand a little bit how the product cycle eventually lands.

Jason P. Rhode

*President, Chief Executive Officer & Director*

A

Yeah. Well, qualitatively, there's definitely dynamics in play this year that Cirrus hasn't had in the past just due to the inclusion of Wolfson and the fact that some of their business is on a different cycle, different production introduction, et cetera. So hopefully that should be a good complement to the cyclical that Cirrus has typically had.

Tore E. Svanberg  
*Stifel, Nicolaus & Co., Inc.*

Q

Very good. And then on the inventory question, you mentioned you would like to build a little bit more, and I was hoping you could just add a little bit more color there. Are we talking about front-end, back-end? Is there a bottleneck anywhere that could potentially open up for you in the March quarter?

Jason P. Rhode  
*President, Chief Executive Officer & Director*

A

Well, I mean, one thing that is a dynamic, it's obviously there's a mix of products that make up our total inventory. As we transition more to 55-nanometer and 65-nanometer, obviously we expect the volume of our devices to remain or remain high and grow, but the volume of wafers we need to support that decreases a lot because it's, number one, a 12-inch wafer and obviously the [ph] feature (22:43) size of the devices are smaller. They're more expensive, but they're smaller. So that gives us, as we ramp these various different 55-nanometer and 65-nanometer products, we're talking about this year, we would certainly expect that component of the inventory to grow significantly, but that's not this quarter statement.

Tore E. Svanberg  
*Stifel, Nicolaus & Co., Inc.*

Q

Okay. Just one last question, Jason. You've always talked about new opportunities being in voice, but then also on MEMS microphone. If I look at those two, which one should we think of as coming first, meaning being at potentially a higher percentage of your revenue?

Jason P. Rhode  
*President, Chief Executive Officer & Director*

A

Voice in general is certainly going to drive near-term growth more rapidly. Microphones are an investment I'm very thankful that we have now in our portfolio as part of the Wolfson deal and part of also, frankly, what we were working on at Cirrus prior to the deal. But we were able to combine those efforts and move forward a little more quickly. But still it's a ways out from being a meaningful contributor to revenue for us. We see that being a good business. We're in the process of establishing ourselves and starting to – and really kind of ramping the volume there. But the long term for us is in being the provider of the audio signal chain all the way from the microphone to the speaker, speaker driver and optimizing that altogether.

We think there's great opportunities to optimize the codec and the microphone together in ways that deliver better performance and better cost structure for customers overall. That should be very favorable to us given our position in the handsets in particular that are kind of the highest volume, things that are out there. So the MEMS thing is significant, but it's further out. The voice is here now and just about every customer we talk to is jumping up and down about it.

Tore E. Svanberg  
*Stifel, Nicolaus & Co., Inc.*

Q

That's very helpful. Again, nice quarter.

Jason P. Rhode  
*President, Chief Executive Officer & Director*

A

Thanks. Appreciate it.

**Operator:** [Operator Instructions] Your next question comes from the line of Blayne Curtis from Barclays. Your line is open.

Christopher Hemmelgam

*Barclays Capital, Inc.*

Q

Given that it looked like there was some space in the queue, I thought I'd jump back in and give a quick follow-up. I was just hoping that you could talk a little bit about some of the opportunities you have in non-portable. It seems portable is going extremely well, but I was just curious, I mean, with all the new features you're developing, do you think that that's going to be applicable to the non-portable space, and is that a business you think can grow this year?

Jason P. Rhode

*President, Chief Executive Officer & Director*

A

Yeah. Obviously we've got a number of new investments in that area given that we've got the existing portfolio from Cirrus and from Wolfson. It's something that is definitely an area where having put the two companies together, we've got more critical mass in that space. There is, I kind of indicated earlier, there's been a long period where there hasn't been a ton of innovation in the home, and we see a lot of companies that are really targeting that space now. And voice is a pretty good interface for a lot of different devices, whether it's remote controls or any number of different things. So we see that as a good opportunity in the longer term for our stuff. That can be with our same existing smart codecs. They're incredibly high performance even though they're low power. So it's certainly high enough performance for any of the home applications that we would typically target.

Same is true for automotive. There's a lot happening in automotive electronics, so as not only the car market itself is quite large, but a lot of the features that would have historically been reserved for kind of higher end models have been really permeating down different manufacturers lineups. Certainly, Android and some of the other folks have got some initiatives that should drive interest in automotive audio. The automotive cabin's a good environment for voice interaction as well. So it's not nearly as big as portable audio is for us and handsets in particular, but it's a great place for us to redeploy a lot of the very same technology we've already developed and we're continuing to see opportunities for that for the existing products in the short term and then, over time, new products as well.

Christopher Hemmelgam

*Barclays Capital, Inc.*

Q

That's excellent. I mean, would you say that's an opportunity that could drive revenue in calendar 2015, or just given the lifecycle of those products, is that more of a 2016 and beyond timeframe?

Jason P. Rhode

*President, Chief Executive Officer & Director*

A

I mean it's already a non-trivial part of our business. It's a slower growth. I think it's a slower growth space in general and so it'll take place over time. There's not any one single socket that you can go win that is really going to move the needle overall either. So you're aggregating a bunch of smaller designs wins. But that is for the most part, that's the nature of the business we're in. We just happen to have a couple outliers to that model.

Christopher Hemmelgam

*Barclays Capital, Inc.*

Q

Thank you very much.

A

Jason P. Rhode  
*President, Chief Executive Officer & Director*

You bet. Thank you.

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**Operator:** [Operator instructions] I will now turn the call back over to Chelsea Heffernan.

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Chelsea Heffernan

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

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Jason P. Rhode  
*President, Chief Executive Officer & Director*

In summary, Q3 was an outstanding quarter for Cirrus Logic, as strength in portable audio fueled revenue growth and operating profit expansion. With an exceptional customer base and a broad range of industry-leading products, we are very excited about the prospects for Cirrus Logic going forward. We expect to deliver year-over-year growth in Q4 and FY 2016, driven by continued strong market for our innovative audio and voice products, a compelling lineup of new product introductions and significantly improved contributions from the Wolfson acquisition.

I would also note that we will be presenting at the Stifel conference on February 10 at 10:20 A.M. Pacific Time. We will also be presenting at the Morgan Stanley conference on March 5. A live webcast of these events will be available at [investor.cirrus.com](http://investor.cirrus.com).

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

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**Operator:** Ladies and gentlemen, this concludes today's conference call. You may now disconnect.

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