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# Cirrus Logic, Inc. (CRUS)

Q1 2016 Earnings Call

## CORPORATE PARTICIPANTS

Thurman K. Case  
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Contact*

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

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## OTHER PARTICIPANTS

Blayne Curtis  
*Barclays Capital, Inc.*

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

Ruben Roy  
*Piper Jaffray & Co (Broker)*

Tom Sepenzis  
*Northland Securities, Inc.*

Christopher J. Longiaru  
*Sidoti & Co. LLC*

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## MANAGEMENT DISCUSSION SECTION

**Operator:** Ladies and gentlemen, thank you for standing by. Welcome to the Cirrus Logic First Quarter Fiscal Year 2016 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.

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Thurman K. Case  
*Chief Financial Officer, VP-Finance, Treasurer & Investor Relations Contact*

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 first quarter fiscal year 2016 at approximately 4 PM, Eastern. 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 discussions of risk factors that could cause actual results to differ materially from our current expectations.

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

## 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're pleased with Cirrus Logic's performance in the June quarter, as we delivered solid revenue, operating profit and earnings per share results. Strong demand for our smart codecs and amplifiers pushed revenue above the high end of our guidance. As we move into Q2, we continue to expect FY 2016 to be an excellent year as content expansion and share gains with existing customers drive meaningful revenue growth.

We are delighted with our progress over the past several quarters as we successfully began shipping a new 65-nanometer smart codec in volume and we are on track to ramp our new 55-nanometer smart codec in the second half of the calendar year.

Customer interest in our ultra-low power components is gaining momentum as the ability to differentiate end products with innovative audio and voice features becomes more essential. As a key enabler of this technology, we believe we have positioned the company for sustained growth in FY 2017. Our first priority is to further strengthen our relationships with our existing customers and increase content, including cross-selling boosted amplifiers, smart codecs and ultimately microphones. Second, building on this momentum, we are working to expand our market share in smartphone OEMs 3 to 10, while driving a subset of the audio and voice features currently found in flagship devices into the mid-tier. We're very encouraged by the progress we have made with these initiatives.

We are particularly excited to be ramping a smart codec over the next few quarters in another top Android smartphone OEM. Longer term, our strategy is to leverage the technology we have developed for mobile devices into adjacent markets, including wearables smart accessories, and the connected home. With an outstanding portfolio of products on the market today, the compelling road map that targets the rapidly growing audio and voice market and an exceptional customer base, we are very confident in our future success.

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

Operator, we are now ready to take questions.

## QUESTION AND ANSWER SECTION

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

Blayne Curtis

*Barclays Capital, Inc.*

Q

Hey. Thanks. Good afternoon, guys. Nice results. Maybe first one for Thurman, if you could just look at June and you had made some comments last quarter about a flattish September doing for growth now. Just curious how the quarter played out, if this was what you're expecting.

And then, in the Shareholder Letter, there's some mention about the September-December quarter, things can move around. Just want to understand what you meant by that comment. Is that a – or did you take some extra conservatism in September? Or is there some – is that comment more related about December? Thanks.

Thurman K. Case

*Chief Financial Officer, VP-Finance, Treasurer & Investor Relations Contact*

A

Well, I'll go ahead take a crack at that. As we indicated on the last call, there were a number of moving parts in play last quarter. We've got new customers to us so we've got – we saw some signs that things might just play out a little bit differently from a seasonal perspective than they would typically do. And as it turned out, things got better than we expected at the time, which was already a pretty good set of expectations. They went up from there, and as well the seasonality fell more in line with normal trends.

And then on the September-December comment, I think we've made that same comment most years in the September-December timeframe and occasionally at other times of the year. It's really common leading into the Christmas season that customers have got ramps that are pretty steep at that timeframe. And so things can change by a week one direction or the other that have nothing to do with the health of our business and yet move our financial results. That skews them from one quarter in either direction.

And so we just like to put that in there to note that it's obviously something that the investment community pays a lot of attention to, but actually doesn't really have a whole lot to do with the actual health of our business. So we'd just like to put that cautionary note in there. Obviously, whenever we see things that are potential gotchas out there, we like to be conservative on that front. But anyway, that's where that tagline came from.

Blayne Curtis

*Barclays Capital, Inc.*

Q

Thanks, Jason. And then, as you look at – in the June quarter, you talked about in the letter the 55-nanometer part really contributing in the second half of the calendar year. So, by that, should I assume that any contribution in the June quarter was small?

Jason P. Rhode

*President, Chief Executive Officer & Director*

A

Yeah. That's a perfectly reasonable assumption.

Blayne Curtis

*Barclays Capital, Inc.*

Q

And then just, finally looking forward, you mentioned several of your growth drivers in the letter. What kind of visibility do you have into the amps? It seems like the most near-term opportunity for you in terms of regaining that attach with the codec, and as well as your thoughts on stereo amps in the smartphone ecosystem over the next couple of years.

Jason P. Rhode

*President, Chief Executive Officer & Director*

A

Well, I mean I don't want to comment on specific design wins that we are pursuing, but generally speaking, people are doing lots of creative stuff with our amplifiers. It's a big and growing product line. Like we've noted in the Shareholder Letter, we're extremely confident that we're going to continue to be able to grow that going forward. Obviously, that's not 100% up to us, but we see very good opportunities to continue to do that.

There's a bunch of sockets where there's an amplifier of some sort right alongside – or potential to be an amplifier right alongside one of our smart codecs out there and that scenario where we think we should have a significant strategic advantage because we control a lot more DSP horsepower at it than someone else might via our smart codec. So, as things continue to move in the direction where a smart codec adds value in a socket, I think that gives us significant advantage to our amplifiers. And again, there's just a number of the trends in the market that we think continue to make that a pretty attractive subset of our market that we serve.

Blayne Curtis

*Barclays Capital, Inc.*

Q

Great.

**Operator:** The next question comes from the line of Ruben Roy with Piper Jaffray. Your line is open.

Ruben Roy

*Piper Jaffray & Co (Broker)*

Q

Thank you and nice job. Congrats, guys, on the nice results.

Jason P. Rhode

*President, Chief Executive Officer & Director*

A

Thanks.

Ruben Roy

*Piper Jaffray & Co (Broker)*

Q

Jason, I wondered initially if you can maybe characterize your continued expectations, as you've cited for a couple of quarters now for significant growth this fiscal year. In light of some of the macro headwinds in Europe and elsewhere, foreign currencies, et cetera, obviously you have a lot of company-specific positives here with some new product shipping and new wins. But in terms of the macro, has your outlook for the fiscal year changed much relative to three months ago?

Jason P. Rhode

*President, Chief Executive Officer & Director*

A

No. I would say, if anything, it's gotten better in terms of the things that we can control. I would say that, obviously, we don't have any ability to impact how many of a particular device one of our customers sells in Greece or China or whatever. So that part is no more known to us than it is to you. But I would say in terms of the things that we're involved in, the demand for our products, the sockets that we're winning, I would say that environment continues to get better.

For the most part, FY 2016, kind of is what is and it does depend on how well our customers' products sell. But generally speaking, we like to – we're cognizant of all the scary stuff and headwinds that you mentioned and we try to take that into account. So I think we're in good shape relative to that in our growth expectations.

Some years, we really are at the mercy of – like last year, for example, really was not a big year of new product introductions for us. And as it turned out, we're partnered with the right customers and they did an incredible job of knocking the cover off the ball. This year is, we've been telegraphing for a long time, is a significant year of new product introductions on a bunch of fronts with big transition to 55-nanometer, which the only reason for us to do that is to increase our content and add more digital functionality and capabilities that hopefully help our customers make their products even more successful than they've already been.

So, while we're coming off a pretty amazing base from last year, we've got a number of company-specific things going our direction as you indicated. So, I don't view us as a story that's very macro. There's probably a little bit of less correlation with our success this year and what the general macro is doing overall. Obviously, it scales things but we're not dependent on the macro being amazing for us to have a really good year regardless.

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**Ruben Roy**

*Piper Jaffray & Co (Broker)*

Q

Thanks, Jason. That's really helpful. And I just had a quick follow-up for Thurman.

On the OpEx, another quarter of pretty material pickup, understandable, and you talked about some of the drivers behind that: development cost, employee expenses, et cetera. I'm just wondering can you characterize that is – is that sort of – some of these real-time design wins and activity you're seeing that's driving that? Or is this part of the plan and maybe how you think that trends into the second half of your fiscal year? Thanks.

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**Thurman K. Case**

*Chief Financial Officer, VP-Finance, Treasurer & Investor Relations Contact*

A

Well, it really is part of the plan, and we would expect to continue to invest in R&D. If you look at where we ended for this quarter, we would really see R&D growing somewhere between 2% and 3% per quarter for the rest of this year. We would note, though, that when you look at R&D, we can have a certain amount of tape-outs in mass sets in one quarter and so you can see some fluctuation in that number. Additionally, then on the SG&A side, we would expect that to be very flat going through the year and we don't expect any growth in that.

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**Jason P. Rhode**

*President, Chief Executive Officer & Director*

A

And then, I'll just add to that on the R&D line, in particular. Our view is that in order to continue to deliver the growth that we'd like to see that we think it's pretty important to keep ourselves somewhere in the range of 17% R&D on an annual basis. Obviously, as Thurman just indicated, that moves around a bit on a quarter-to-quarter basis as we get – it always seems like you get a bunch of tape-outs one quarter and maybe none the next quarter. So it can be a little bit lumpy on a quarter-by-quarter basis, but that's where we need to be.

And our big concern frankly, much like happened in 2012, is that if we don't have our foot to the floor on the hiring front, then we have the potential to get behind where we are on a model and that's not a good place because we've got some pretty lofty aspirations as far as growth goes in the future and that stuff needs to be staffed in order to happen.

Ruben Roy

*Piper Jaffray & Co (Broker)*

Makes sense. Thanks, guys.

Q

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

Christopher J. Longiaru

*Sidoti & Co. LLC*

Hey, guys. Congrats on the results.

Q

Jason P. Rhode

*President, Chief Executive Officer & Director*

Thanks, Chris.

A

Thurman K. Case

*Chief Financial Officer, VP-Finance, Treasurer & Investor Relations Contact*

Thanks.

A

Christopher J. Longiaru

*Sidoti & Co. LLC*

So you're a little bit higher on the gross margin line, but it sounds like it wasn't a whole lot of the progression to 55-nanometer. So can you just give us a little bit of color into why the gross margin was higher and what your ideas are to put you at the low end to the high end of the range in terms of the guidance?

Q

Thurman K. Case

*Chief Financial Officer, VP-Finance, Treasurer & Investor Relations Contact*

Well, we came in at the high end of the range. A big piece of that was supported by supply chain improvements. That was offset a little bit by a higher mix of portable product sales. So between those two, we did see some improvement in the margins going to the higher end of what we expected.

A

Jason P. Rhode

*President, Chief Executive Officer & Director*

I mean, I would say we put a plus or minus 1% range on OpEx is actually fairly aggressive in terms of being a pretty tight range for us. It can easily move around a percent or so on mix, so it's not terribly surprising for us to be at the high end. So we give you the range we give you because we think the prudent thing to do is to model the center of it, but moving a percent one way or the other doesn't usually mean much.

A

Christopher J. Longiaru

*Sidoti & Co. LLC*

Q

And then just in terms of – so you paid out about \$20 million in debt, do guys have a goal, an annual goal or kind of what your expectations are for using the cash?

Thurman K. Case

*Chief Financial Officer, VP-Finance, Treasurer & Investor Relations Contact*

A

Yeah. I mean from cash usages, our number one goal is to invest in R&D and to fuel the organic growth, and that's to Jason's point that he made earlier that we'd like to keep our R&D at a healthy level of 17% or so. After that, we've been looking at acquisitions we've done. We certainly did the Wolfson acquisition recently. We look at tuck-ins that would help us in terms of boosting technology whether it be in hardware or software.

Beyond that, the next two categories are the pay-down of debt and then share repurchases. And we look at both of those as something we will do on an opportunistic basis. And every quarter, we look at how we want to utilize cash and what our best path is to return some value to the shareholders, and that's how we do it.

Christopher J. Longiaru

*Sidoti & Co. LLC*

Q

That's helpful. And then just in terms of the LED asset sale, is there a lot more there that you guys still have or – I know that you've talked about trying to monetize some of that, could you just talk to that?

Jason P. Rhode

*President, Chief Executive Officer & Director*

A

Well, it was a sale of not all of the LED patents, but we had an opportunity to monetize something that we weren't using. It didn't have an expectation that we were likely to need and patent sales are something that we approach. It's not a core business for us, so it's not something we're really aggressive about. And we always up with concerns about do you end up selling patents that end up in the hands of a patent troll. In this case, it was somebody that actually practices the art and is in that line of business so we didn't have concerns there.

So it just seems like a good home where somebody could get some value out of the hard work that our creative engineers have done over the years and put some money back in the coffers so we can deploy more effectively. So, it's not something that we really pursue actively all the time.

Christopher J. Longiaru

*Sidoti & Co. LLC*

Q

Great. That's helpful. Thanks, guys. I'll jump out.

Jason P. Rhode

*President, Chief Executive Officer & Director*

A

Thanks, Chris.

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

Tore E. Svanberg

*Stifel, Nicolaus & Co., Inc.*

Q

Yes. Thank you. My first question is you're saying in your Shareholder Letter, you're targeting share gains with the smartphone OEMs 3 to 10. I'm just wondering, is that going to be sort of more custom parts or would that be more standard parts?

Jason P. Rhode

*President, Chief Executive Officer & Director*

A

No. We really see the best opportunity to grow our business in that segment of the market with general market products such as what the UK team has been developing. It's not that many customers where you can be confident two or three years in advance that you can work with them and develop a custom piece of hardware that's going to fit what they want because a lot of them don't know that far in advance exactly what they're going to want.

So the strategy that we have is to develop a general market product that's very programmable, features the best analog or mixed-signal inputs and outputs and all of the various bells and whistles that go with one of our smart codecs, and then provides a lot of flexibility in terms of the software customization that we can do.

And so that's pretty typical of our – what our approach will be across the Android market is to really try to provide a great platform via the chip and then provide a lot of customization in terms of our own IP, third-party IP working with our partners that are coming up with neat and clever ideas all the time. And then, of course, all the customers out there that we typically do business with have got ideas of their own or algorithms or EQs or you name it that they want to integrate. So we provide tools and support and everything else, which enables our engineers to be in really good position to assist with the system integration and bring all that together to achieve the goal.

So it's pretty different than I guess you'd call the traditional – the Cirrus business from before which is custom chip-based. But it's a really great approach to the Android market because it enables us to deliver customers' differentiation but do it on a timescale that they can actually realize. That strategy is working out now great. It has been working really well on the flagship and we're starting to see that get more traction in the mid-tier and then across the 3 through 10 accounts.

A number of those accounts are still, like we said in the Shareholder Letter, going to be more focused on add-ons, amplifiers, and maybe high-performance D-to-A converter. But over time, we continue to expect more and more of those accounts to be able to make their own decisions about what sort of audio devices they want to use and come up with neat and clever ways to differentiate their products in the pursuit of trying to have a little bit of margin they can keep for themselves.

Tore E. Svanberg

*Stifel, Nicolaus & Co., Inc.*

Q

That's really helpful. And without getting too technical, you mentioned the always-on voice functionality and they intend to market that more meaningfully. What does that really mean for your content per unit here? And again, I'm not trying to get too complex on the technology side of things, but it just seems like that is something that could potentially expand your content quite a bit.

Jason P. Rhode

*President, Chief Executive Officer & Director*

A

Well, so it's interesting. Actually, the support for that function has been in the line of devices we've derive – this is really a general market statement. Obviously, they don't talk too much about the other side of things. That support for that function has been in the UK team's smart codec, even the one that shipped last year.

The thing about always-on voice is that it's such a unique intersection of really difficult things. You got to be able to do the high-fidelity audio and voice A-to-D conversion that we're well-known for. But by always-on, historically, I think there's always been an asterisk by always-on, but what we're hearing from a lot of the Android market is they really want always-on to not have an asterisk. They want it to really be always-on, not just when it's plugged in. And to do that, it requires just an incredibly low power front end.

So, obviously, there's algorithms that go along with that and we support those. We've got elements of our own software that get worked in with third parties or work with software from our customers to enable the full always-on voice feature. But we really view it as something that our hardware can provide meaningful value to by being incredibly low power and interfacing to the system in a way that can really add value.

Long term, incorporating – obviously, microphones are a neat investment for us. They're not a huge part of the business today, although they're growing in volume. But in the long term, we see the design of microphones and smart codecs in tandem as a system as being something that adds a lot of value in a number of applications, always-on voice being kind of at the front of the list because the more smarts we can cram into the microphone up front of the system, then that gives us more opportunities to control the power consumption through the whole signal chain.

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

Q

Okay. Thanks. Just one last question. So, if you look at the inventory, it's obviously up quite significantly and you tend to do that ahead of big product ramps. It just feels like this time around, it's a little bit higher ahead of this – meaning, the September quarter unit growth doesn't seem as high. So, is that because you have some completely new products with much higher dollar content here? Or has it even something to do with getting ready for 55-nanometer and just making sure you will not have any yield issues, anything like that?

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

A

Well, it's really less about yield but it – I mean, obviously, we've telegraphed that we expect to ramp 55-nanometer and we've said pretty directly that that is about increasing content. I would say the relative change from, say, the beginning of Q1 to what we're kind of telegraphing going forward is it is definitely saying good things about what we expect. Obviously, we expect to grow this year so that would imply we got to grow our product inventory. But also, we've been in a situation this last spring where it was definitely a challenge to keep up with demand and that drove our inventory levels to significantly lower than we would normally like to see.

So, one of the great things about moving from 180-nanometer to 55-nanometer for the workhorse node for our product line is we were a very large percentage of a fab worth of 180-nanometer. As we move our workhorses from those older geometries into 55-nanometer or 65-nanometer, our spend with our vendor goes up. So that's good. Our importance with the vendor goes up and consequently, our selling prices out go up as well. But our fraction of a particular fab's capacity goes down quite a lot, which is really great news. That gives our supply chain team a lot more flexibility and ability to grow inventory when we need it and rather than living hand to mouth like we've been doing a lot this spring.

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

Q

That's really helpful. Thank you. Great quarter, guys.

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

A

Sure. Thanks, Tore.

Thurman K. Case  
*Chief Financial Officer, VP-Finance, Treasurer & Investor Relations Contact*

A

Thanks.

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

Tom Sepenzis  
*Northland Securities, Inc.*

Q

Thanks, and I'll echo my congratulations on the quarter and the guidance. I was just wondering if you could give us any color, you mentioned you have a new Android customer. You mentioned it was a top customer. Is that meaning a top-tier kind of Tier 1 provider or just top as in unit volumes? Any color around kind of whether this is a mid-tier device or a high-end device?

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

A

No, I don't want to telegraph anything more than we have in terms of what account that is. It's their business to launch their products, but it's – obviously, it's somebody we're excited to be working with and it is, I think we noted in the Shareholder Letter, it's with the smart codecs. So that's a big decision on a customer's part. It's a large integration effort and those are the stickiest sockets that we sell. So, we're very excited to see that technology taking hold elsewhere in the market.

Tom Sepenzis  
*Northland Securities, Inc.*

Q

Great, thanks. And then in terms of the June quarter, with the mobile products, I mean can you talk about the ASP trends that you're seeing right now on a blended basis overall for the company?

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

A

Well, we have said that going forward, we do expect to grow our content through the course of the year. The products that we've ramped in 65-nanometer earlier this year were certainly a step-up from what the UK team have been shipping before. And we've talked a lot about 55-nanometer being all about delivering more value for our customers going forward. So, I don't know looking at on a quarter-by-quarter basis, but on the whole, certainly our blended ASP I would expect to continue to go up.

Tom Sepenzis  
*Northland Securities, Inc.*

Q

Great, thank you. And then last question from me. Just in terms of the tax rate, you mentioned that you – given that a lot of the sales will be counted overseas, you could see it drop down from the 30% level. So what should we be thinking out a year, kind of mid-20% or high 20% or how do you see that drop?

Thurman K. Case

*Chief Financial Officer, VP-Finance, Treasurer & Investor Relations Contact*

A

Well, for FY 2016, we would expect it to be – the effective global tax rate to be around 30% for this year. If you look out into 2017 and maybe the next couple of years after that, the best way to look at it for right now would be a reduction of around 2% per year.

Tom Sepenzis

*Northland Securities, Inc.*

Q

That's great. Thanks so much. Appreciate it.

Thurman K. Case

*Chief Financial Officer, VP-Finance, Treasurer & Investor Relations Contact*

A

Thanks.

**Operator:** [Operator Instructions] There are no additional questions on the phone line. I would now like to turn the call over to Ms. Chelsea Heffernan.

Chelsea Heffernan

*Manager-Investor Relations*

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

Jason P. Rhode

*President, Chief Executive Officer & Director*

Thank you, Chelsea. In summary, Q1 was another great quarter for Cirrus Logic. We're extremely pleased with our financial results as strong demand for our smart codecs and amplifiers drove revenue above the high end of our guidance. With a comprehensive portfolio of products, a compelling strategic road map, and outstanding customers, we are excited about our outlook for growth in FY 2016 and FY 2017.

I would also like to note that we will be holding a Virtual Annual Shareholder Meeting on Wednesday, July 29 at 11 AM Central Time.

If you have any questions that were not addressed, 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. Good-bye.

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

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