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Cirrus Logic, Inc. (CRUS)

Q2 2016 Earnings Call

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Christopher Hemmelgarn
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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, thank you for standing by. Welcome to the Cirrus Logic Second 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.

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 Director of Investor Relations. Today, we announced our financial results for the second 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 on 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.

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 our Q2 FY 2016 results, as robust demand for our 55-nanometer and 65-nanometer smart codecs and boosted amplifiers drove revenue up 9% sequentially and 46% year-over-year. FY 2016 continues to be an outstanding year, as share gains and content increases drive strong growth. We are very encouraged with the progress we made this past quarter towards our strategic initiatives that we believe will fuel continued growth in FY 2017.

In the handset market, we have successfully expanded our content in existing customers, captured new smart codecs sockets at a leading manufacturer, and are actively engaged with numerous other market leaders to further broaden our customer base. The company continues to invest substantially in R&D as we target rapidly growing markets, where our ultra low power, sophisticated analog and mixed signal processing components add value and an ability to differentiate. With the comprehensive portfolio of audio and voice products and an extensive roadmap, we believe our technology is particularly well suited for smartphones, digital headsets, smart accessories, and the connected home.

We are keenly focused on growing our content at our top three smartphone customers, while expanding share with other market leaders. We remain actively engaged with leading OEMs and are encouraged by their desire to provide compelling audio and voice solutions across a variety of flagship and mid-tier platforms. Longer-term, as features such as noise cancellation and always-on voice move beyond smartphones, we believe there is a significant potential for our disruptive smart codec technology in the digital headset and smart accessory markets. As a leading innovator in audio and voice technology, we are well-positioned to capitalize on these market opportunities and deliver growth in the coming years.

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 are now ready to take questions.

QUESTION AND ANSWER SECTION

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

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

Q

Yes. Thank you, and congratulations on the results. I guess the first question and I know it's tough to answer this, but as far as the visibility you have now versus let's say, 12 months ago, how would you classify that?

Jason P. Rhode
President, Chief Executive Officer & Director

A

Well, I mean the precision that we get around giving guidance and all of that I would say is very similar. We're a proprietary supplier of pretty complicated devices; customers have either designed us in or not at this point. And so, to some extent, we're at the – toward – rather to a larger extent, we're at the mercy of how good of a job that they've done with their forecasting. We're blessed frankly in that regard to work with really remarkably good customers that do a great job with their forecasts. I, frankly, it's fairly amazing how well some of them do at predicting what they're going to need in a particular quarter. But there is a reason, we don't go out past the further – any further past a quarter. When it gets to specifics, it's difficult to get it real precisely. But I would say visibility wise, generally pretty similar to what we've had in the past; some customers little more predictable than others, but generally speaking, our visibility is similar and really very good, frankly.

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

Q

Very good. And I'm not sure if you've mentioned this in your Shareholder Letter, but your 55-nanometer revenue obviously is ramping now, is that a number that you care to share with us, I mean in percentage of revenue that's based on 55-nanometer?

Jason P. Rhode
President, Chief Executive Officer & Director

A

No, that's not something we're ready to break out, but it's definitely moved way up the chart and we expect that node to be a workhorse for us for many years. We don't think we'll be nearly as late getting to 28-nanometer as we were getting to 55-nanometer, but nonetheless, I think for the smart codecs, 55-nanometer is a really a nice node. The analog capabilities that we have there combined with the ability to differentiate with a lot of memory and a lot of signal processing capabilities, really makes that a nice sweet spot for us.

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

Q

Very good. My last question, would you care to share any more details on your opportunity in digital headsets? I think you've talked about an opportunity in the next 12 to 18 months, but any other color that you can share with us at this point?

Jason P. Rhode
President, Chief Executive Officer & Director

A

So, yeah, specifically what we've developed over the last couple of years is a noise cancelling headset chip for the general market. We've been out promoting that to various different customers; there's a lot of interest in it. We'll see who gets to the finish line first, but it really enables a pretty remarkable experience that isn't quite so dependent on form factors – pretty heavily digital signal processing, adaptive solution. So it really delivers incredibly compelling performance and a lot of customers are interested in that and figuring how to adapt their product plans to incorporate the device.

So, we feel good about that as really kind of one of the first meaningful opportunities that is emerging in kind of what we would call the smart accessory space for the types of things that we develop. We don't think that's the last of those things that will emerge by any stretch, but it is something that's probably sooner rather than later.

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

Q

Very good. Thanks again, and congratulations.

Jason P. Rhode
President, Chief Executive Officer & Director

A

You bet. Thanks, Tore.

Operator: Your next question comes from the line of Blayne Curtis with Barclays. Your line is now open.

Christopher Hemmelgarn
Barclays Capital, Inc.

Q

Thanks for taking the question. This is Chris Hemmelgarn on for Blayne. Congrats on the good quarter and guidance, guys.

Jason P. Rhode
President, Chief Executive Officer & Director

A

Thank you, Chris.

Christopher Hemmelgarn
Barclays Capital, Inc.

Q

I guess, yes, I guess, first of all, outside of your ramp of your largest customer upcoming, can you talk about trends in the Android market into December, just in terms of inventory corrections? And are you seeing any new ramps at customers and where do you see your best opportunities there?

Jason P. Rhode
President, Chief Executive Officer & Director

A

Well, I mean, inventory corrections are something that we're thankfully not hugely exposed to in most places. Obviously, our customers can have inventory in their channel and we have no ability to control that or any visibility into it frankly. But generally speaking, distributors are a pretty small part of our business. Most of our large OEM customers manage their inventory very carefully and very well. So, it's rare that we end up having any sort of meaningful impact of too much of our inventory prior to having been consumed by a customer.

So, no real issue there. We're excited this past quarter to launch and ramp into three or into a handful of new handsets with the smart codec devices, which is, as we've talked about before, a pretty sticky device and a pretty

compelling type of a product from us. Those phones were really well received, very well reviewed, so it's something we're real proud of. There's a lot of audio and voice features that are really showcased in those devices. As far as products that haven't yet been launched, that's – it's not really our place to get out in front of our customers and do their PR for them – but we feel good about our opportunities going forward.

Christopher Hemmelgarn

Barclays Capital, Inc.

Q

Fair enough and thanks for the color. I guess, you also mentioned in your investor letter that you're very optimistic about growth this fiscal year and in 2017. Obviously, you get some follow-through from the content gains at your largest customer, but I guess could you talk about where you see the best opportunities for growth in fiscal year 2017 and beyond?

Jason P. Rhode

President, Chief Executive Officer & Director

A

Well, it's really more of the same. We see good opportunities for our smart codecs continue to do well. Amplifiers is a great business for us that we've been able to grow, really since that product line's inception a few years ago; it's now a big and growing business for us. We see really good opportunities for that to continue to grow in the next – really next year and beyond. The headset thing is a little bit of a question of when people start latching on and shipping it and all of that, but the technology is so compelling that we really feel like that's something that is – that's something that our customers are going to get behind and want to differentiate around. So, we're out shopping that to a number of people as I mentioned before, and feel pretty confident that somebody is going to latch on to that in a big way. It's – I've been flying around with a demo set myself of what we've created, and it's just such a neat thing to have; they're really compelling.

Christopher Hemmelgarn

Barclays Capital, Inc.

Q

Okay.

Jason P. Rhode

President, Chief Executive Officer & Director

A

So, there's a number of areas for growth. Really, as I look around, I see growth opportunities pretty much everywhere for our product lines.

Christopher Hemmelgarn

Barclays Capital, Inc.

Q

Thank you very much.

Jason P. Rhode

President, Chief Executive Officer & Director

A

You bet.

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

Christopher J. Longiaru

Sidoti & Co. LLC

Q

Hey, guys. I'll echo my congratulations – great quarter, great guide.

Jason P. Rhode

President, Chief Executive Officer & Director

Thanks.

A

Christopher J. Longiaru

Sidoti & Co. LLC

So, my first question just talks – you talked about ramping some general smart – market smart codecs and microphones in the quarter. Are these geared more towards kind of the mid-tier smart phone, and how – can you elaborate on maybe how the design cycle or how the sales process works differently for something like that?

Q

Jason P. Rhode

President, Chief Executive Officer & Director

Well it's, I mean, smart codecs are a big investment by a customer and it's a pretty sticky socket. It takes a long time for any of our customers to design that type of thing in. You can find more – I think there's teardowns that are out there just recently – so you can probably find a little more detail on that. But I would say the design cycle is – you could use the rule of thumb we've given in the past – of ballpark of a year from a time the customer really engages to the time they can launch a device, give or take a little bit here or there. And in particular, if there's going to be lot of software involved, a lot of voice and audio-based features, then it can be a bit longer than that, but that – the great news is that makes it pretty sticky.

A

As far as high-end and mid-tier, I don't want to cast dispersions on anybody's product line by characterizing it as mid-tier. I think the handsets that we're talking about are all very good; they're very well-received and reviewed. They are connected to a range of third-party apps processors. So, this is kind of a broken bundle type of a product. In a couple of cases, it's with the flagship applications processor and then there's one device that's with what I think people would probably characterize as more of a mid-tier apps processor. But frankly with – coupled with our device – the features and functions that are delivered are things that people are really more used to associating with a flagship phone, which is a trend that we've been seeing coming for a while, is that even in the mid-tier, people are wanting to deliver voice features and functions that are more traditionally associated with the flagship devices. So, it's a big win, one we've been working on for a long time and something we're very proud of.

Christopher J. Longiaru

Sidoti & Co. LLC

And is that process more tied to software tweaking than it is to the hardware tweaking? Can you just give kind of [indiscernible] (14:49)?

Q

Jason P. Rhode

President, Chief Executive Officer & Director

Well, these are general market devices that we can sell to really anybody that they're a good fit for. So, they're not custom devices. There's not a lot of hardware tweaking in that sense. The algorithms, the libraries that we provide – that we provide access to from third parties – and as well as the tools and drivers and all of that that we deliver along with our device so that they can be easily integrated in an android handset with whichever applications processor the customers choose. There is a lot of custom work that is done there on the firmware side and that's a really nice advantage in that market, because that's the kind of timeline that most of the android handset manufacturers are able to move along with. Most of them aren't as much willing to sit around and think about what they might want two or three years from now. But as far as what we want to execute on now and what

A

software is needed to make that a reality, where we can pull that in a much more limited timeframe, that's kind where the differentiation customer by customer comes in.

Christopher J. Longiaru

Sidoti & Co. LLC

Q

And so with that and with that kind of a move, or a diversification away from your largest customer, historically you'd have some seasonality tied to that largest customer. Can you comment on maybe just what your seasonality, you would – how you would expect your seasonality to look going forward?

Jason P. Rhode

President, Chief Executive Officer & Director

A

Well, I mean, we're certainly in a quarter that is, for most of our customers, is typically a pretty strong one and obviously, there's some new product introductions that then lay on top of that seasonality. I view our business as a little bit more product cycle related than it is seasonal, per se, although obviously our customers time their product cycle as they see fit relative to the seasonality, so they're obviously related. As far as product cycle – products cycles and things that we're expecting to be in coming up – again I don't know if it's our place to telegraph what our customers are planning and exactly when. But nonetheless, we feel very good about our opportunities to grow this year and to continue to deliver growth next year as well.

Operator: [Operator Instructions] Your next question comes from the line of Tom Sepenzis with Northland. Your line is now open.

Tom Sepenzis

Northland Securities

Q

Hey, and let me echo my congratulation on another strong performance.

Jason P. Rhode

President, Chief Executive Officer & Director

A

Thanks.

Tom Sepenzis

Northland Securities

Q

So, I was just wondering if you can talk a little bit, give us a little color on what you're seeing in the non-portable. That was up sequentially, and I'm just wondering if you can give us a little color on what's going on there and maybe just in terms of guidance, what we should be expecting, looking ahead a little?

Jason P. Rhode

President, Chief Executive Officer & Director

A

Well, it's a number of different factors that drove that. I mean that's – the Q2 is a pretty typically strong season for those product lines in general. I don't know that there is any major takeaways to be had there, other than just the market is in reasonably good condition – although various prognosticators of doom and gloom notwithstanding – things are actually holding up pretty well. People are buying stuff and we're in good shape as far as the customers we're aligned with. So it's a variety of things that drove those numbers. Again, obviously, the bulk of the growth that we've seen and the largest piece of revenue from the company overall in any event is portable audio. So, I mean that's really the story. We did see growth across a number of other product lines, but obviously the needle mover is portable audio, and that's what people should be focused on if they're thinking about Cirrus Logic.

Tom Sepenzis

Northland Securities

Q

Sure. And then in the Shareholder Letter, you mentioned that for the headphones, that you expect product to come out sometime in the next 12 to 18 months. So does that actually mean it will be at least 12 months or is there a possibility...?

Jason P. Rhode

President, Chief Executive Officer & Director

A

No, that's just us – it's difficult a little bit sometimes to predict your customers product cycle, in particular when we're talking about it would essentially be a new product on the market. We're out promoting it to – this particular device – to a number of potential customers for it. Lots of excitement about it. It's a demo that is really pretty impressive. Frankly, every customer we've shown it to is pretty much said one word is, wow. It's a pretty interesting thing for our customers to think about and what kind of impact they could have on the market there. So, there's a number of other – there's just a number of factors in play that make it a little bit difficult to predict exactly when somebody will come to market with it – but it's something we feel good about that it will actually happen.

Tom Sepenzis

Northland Securities

Q

Great. Thank you very much.

Jason P. Rhode

President, Chief Executive Officer & Director

A

You bet.

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

Tore E. Svanberg

Stifel, Nicolaus & Co., Inc.

Q

Yeah, just had a follow-up on the digital headset, just so I understand the technology here. So, if you sell that to a customer, let's say bundled, does that mean it has to go with your smart codec or could there be a completely – a complete separation there?

Jason P. Rhode

President, Chief Executive Officer & Director

A

No. It – well, it certainly could be – if we had a handset manufacturer that wanted to make noise canceling device that went with the handset, then that could happen, I suppose. But no, it really – you can connect – this is a headset that you could – this chip is essentially is supposed to be the brains in a noise canceling headset that you could connect to a laptop or your home computer or a phone or any number of things. So, there isn't necessarily a direct connection to the smart codec that would be used in, say, a handset.

Tore E. Svanberg

Stifel, Nicolaus & Co., Inc.

Q

Yeah, thanks for clarifying that. And then the second follow-up, you talked about some of the growth drivers next year. The one area that you didn't mention or haven't talked about in detail, but you did mention it in the

Shareholder Letter is the wearables market. If I'm not mistaken, I think you're already shipping to one customer there. So, I was just hoping you can talk a bit more about your opportunity there for next year?

Jason P. Rhode

President, Chief Executive Officer & Director

A

Sure. That's a category of application that is continuing to mature and develop. The device we're shipping in a watch, frankly, is a device that's – it is also a DSP-enabled device with a fair bit of analog on it as well. This was something that was designed specifically for wearables. It's a pretty interesting bit of DSP, really trying to implement functions like always-on voice and some – obviously, some subset of what we would do in a flagship device in a phone. But we'll see how well it's received, and hopefully, it will do well in the market. I've seen the watch. I think it's pretty cool looking, but we'll see how it does over the long-term.

But it's an application space that we're excited about over the long-term. We're engaged with the right customers. We certainly want to continue to invest in that space. And along with automotive and the connected home over the long-term, we really think that it's a great opportunity for Cirrus because we're developing all these technologies for handsets, which is a very high volume market. We can afford to spend the R&D to deploy these things initially in handsets. And then, as these other areas of the so called Internet of Things or smart accessories or the connected home become a reality, then we're in the right place at the right time with technology ahead of time.

Tore E. Svanberg

Stifel, Nicolaus & Co., Inc.

Q

Sounds good. Thanks again.

Jason P. Rhode

President, Chief Executive Officer & Director

A

Yeah. You bet.

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

Christopher J. Longiaru

Sidoti & Co. LLC

Q

Yeah. I just had a follow-up. Just on the gross margins being a little bit better, can you just talk about how much of that is better revenue, how much is supply chain and maybe it's a little bit in – there's 55-nanometers – just give us an idea where the upside is coming from?

Jason P. Rhode

President, Chief Executive Officer & Director

A

Yes. I mean it's a range – it's a range of factors that you touched on all of, I think. Certainly, mix gets into it; there are supply chain improvements that we have from time to time, and yeah, so it's a little bit of quite a number of things go into delivering that result and something the team's done a good job on delivering.

Christopher J. Longiaru

Sidoti & Co. LLC

Q

And as far as mix goes, I mean, that is kind of the – and we've talked about the seasonality a little bit – as that goes down, would you expect the gross margins kind of stay around this level or is there kind of an expectation that

they'll trend more towards your stated goal? Can you just give a little bit of color, as the next couple of quarters progress, what you see?

Jason P. Rhode

President, Chief Executive Officer & Director

A

Yeah. We've telegraphed that we – we think our model in the mid-40%'s works well relative to what we need to spend on R&D and our stated goal of delivering 20% operating. And that's really the goal; obviously, the margin goal is as high as we can get it without making our customers mad. Their goal is generally – their goal is generally zero – and so we try to find the happy medium somewhere in the middle. And so we think as a long-term metric, mid-40%'s is a reasonable spot. There are big companies that supply the handset space that are in that range, so it's defensible from that perspective. But it can move around by a few percentage points; there's ebbs and flows throughout the year and I will kind of keep you updated one quarter at a time, I guess.

Christopher J. Longiaru

Sidoti & Co. LLC

Q

And then just on the smart home, any updates there in terms of design, design wins or...?

Jason P. Rhode

President, Chief Executive Officer & Director

A

No, we try to – I mean, you know us well enough to know we don't get ahead of ourselves in terms of talking about meaningful design wins, but we're definitely talking to the right folks in that space. People are doing really interesting stuff with audio and voice in the connected home environment. It's an area that's been ripe for innovation for a great many years, but in order for that innovation to really take hold, somebody needs to defragment the infrastructure that's in the home. And you really see that now, whether it's the folks at Microsoft with their own Cortana stuff; there's a number of other folks in the Bay Area that are working on defragmenting the home and providing a wide array of devices or a framework for a wide array of devices to connect in a home.

And that's really outside of our purview, but once some of those network infrastructures within the home are in place, that gives customers of ours a really good opportunity to innovate and deliver value into the home that is in the form of audio and voice differentiation. And so that's what we're positioned well with. We think we're talking to the right folks and we're excited about that as it unfolds over the coming years. And again it's another – it would be a difficult thing to invest in today if that's what you were going after solely. But given that it's the same sorts of features and functions that we're already delivering in a handset, it's a really nice way to take our existing technology and deploy it in a new market. So, that's something we're really excited about.

Christopher J. Longiaru

Sidoti & Co. LLC

Q

Well, thank you, guys. I'll jump out.

Jason P. Rhode

President, Chief Executive Officer & Director

A

Appreciate it.

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

Chelsea Heffernan

Director of Investor Relations

Thank you, operator. We will conclude the call with questions that we received via email this afternoon. In the Shareholder Letter, you mentioned making a couple of acquisitions in the September quarter. Can you provide a little more information on what they do?

Jason P. Rhode

President, Chief Executive Officer & Director

A

Sure. A little bit more. These are – we did two small acquisitions, I suppose what you would characterize as tuck-in acquisitions – that are pretty different. One, that we referred to specifically in the headset or in the – in the Shareholder Letter – was related to enhancing our software capabilities in the speaker protection space. So, we had the opportunity to acquire a team that has some technology that's already in the market that is well regarded among a number of different customers. It's a little bit different approach than what we've had internally at Cirrus. And once we met the team and realized really how capable the people involved are and how mature the technology they already had was, we were very excited about getting them on board. And so we're a few months in, but they are getting along and working very, very closely with the existing team within Cirrus, and I think that's moved us forward pretty well.

The other one is a little further out on the time horizon. It's – and so, I'll be a little bit less specific about what we're working on there – but it's really more of a research effort that is targeted towards some of the biometrics that we could conceivably get involved with as far as voice is concerned. So, identifying people simply by having access to their voice rather than necessarily a recorded pass-phrase or things of the sort. So, that's not something to bake into any revenue models in the short-term, but it's something that felt like it's very squarely within our wheelhouse, and it's a pretty intriguing concept of things that we could with that down the road.

Chelsea Heffernan

Director of Investor Relations

A

Thanks, Jason. That was the final question.

Jason P. Rhode

President, Chief Executive Officer & Director

All right. Thank you. In summary, we were very pleased with our financial results for the second quarter as sales of our 55-nanometer and 65-nanometer smart codecs and boosted amplifiers accelerated.

Cirrus Logic's substantial investment in R&D, diverse product portfolio spanning the entire audio signal chain, and innovative strategic road map have positioned the company as an industry leader. We continue to be very excited about our outlook for growth in FY 2015 – sorry FY 2016 and FY 2017 – as demand for our audio and voice products continues to gain momentum.

I would also like to note we will be presenting at the NASDAQ conference in London on December 2 and the Barclays Conference in San Francisco on December 9. A live webcast of these events will be available at investor.cirrus.com.

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. Good bye.

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

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