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CRUS - Q2 2019 Cirrus Logic Inc Earnings Call

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OVERVIEW:

CRUS reported 2Q19 revenue of \$366.3m.



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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by. Welcome to the Cirrus Logic Second Quarter Fiscal Year 2019 Financial Results Q&A Session. (Operator Instructions) 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 - *Cirrus Logic, Inc. - CFO, CAO & VP*

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 of fiscal year 2019 at approximately 4:45 p.m. Eastern. The Shareholder Letter discussing our financial results, the earnings press release, including a reconciliation of non-GAAP financial information to most directly comparable GAAP information, along with the webcast of this Q&A session, are all available at the company's Investor Relations website at investor.cirrus.com. This call will feature questions from the analysts covering our company as well as questions submitted to us via e-mail 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, 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'll turn the call over to Jason.



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Jason P. Rhode - Cirrus Logic, Inc. - CEO, President & 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.

Cirrus Logic reported revenue of \$366.3 million in Q2 of FY '19. Revenue exceeded the high end of guidance, as orders for certain portable products moved into late Q2 from early Q3. Predicting revenue for these quarters can be particularly challenging, as we are typically ramping heavily at the quarter boundary and our customers can and frequently do change individual orders on short notice. While our guidance for the December quarter reflects the shift in orders, we note the company's expectations for this 6-month period remain relatively unchanged.

With respect to the company's overall expectations for the remainder of FY '19, the primary drivers of variability include end customer demand for handsets that utilize our products and timing of new smartphone launches expected late in the fiscal year.

We are pleased with our progress in Q2, as design momentum across our portfolio was strong and numerous new devices were announced that use our components. In the smartphone market, we expanded our share with existing customers and began shipping 2 audio amplifiers and a haptic driver in a new North American flagship Android handset customer.

During the quarter, company increased penetration of boosted amplifiers in a flagship and mid-tier smartphones and ramped a new 55-nanometer amplifier with a leading customer. Further, after our initial win in a single smartphone model last quarter, we expanded our footprint with one of the largest Android OEMs and are now shipping boosted amplifiers in multiple models. We expect additional flagship devices using -- utilizing our technology to launch over the next 6 months.

In haptics, we are delighted with our team's execution since Cirrus Logic began investing R&D resources in this product line in calendar 2017. As I mentioned, we are now shipping a haptic driver in our first flagship Android smartphone. While design activity with our first-generation haptic driver is robust and we expect new devices to come to market over the next 12 months using this component, we also plan on taping out our first product designed specifically for haptics in the spring of calendar '19.

With an extensive portfolio of products and a compelling road map, we are encouraged as we continue to see increased demand for products that capitalize on our expertise in ultra-low power, low latency and mixed signal processing. As we look to FY '20 with a solid pipeline of products and meaningful customer engagements, we remain confident in our ability to return to year-over-year revenue growth.

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.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from the line of Tore Svanberg of Stifel.

Tore Egil Svanberg - Stifel, Nicolaus & Company, Incorporated, Research Division - MD

First topic is haptics. So it sounds like you're going to be offering a haptic-specific solution in the spring of '19. I was just hoping, Jason, you could elaborate a little bit on what that means for you as a company, especially when thinking about the integrated DSP and what that can offer customers for flexibility and so on?



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Jason P. Rhode - Cirrus Logic, Inc. - CEO, President & Director

Sure, yes, it's a great question. I'd -- I -- yes, I'd say it's kind of more -- the theme would be more of the same. It's kind of building on the success we've had. Any time you come out with a new device, you first engage a broad market, you learn about things that -- where we can sweep in more and more of the system and just try to make it as turnkey of a product as possible. In particular relative to the Android ecosystem, it really prefer to have self-contained devices that are not having this -- having to do a lot of the development across multiple devices whenever possible. So it's really just kind of a little more purpose built, a little more integrated type of device.

Tore Egil Svanberg - Stifel, Nicolaus & Company, Incorporated, Research Division - MD

Great. And my other question was on voice biometrics. You mentioned in your Shareholder Letter that everything is progressing there. But could you update us on timing on when this could be more of a revenue driver for you? Is it going to be fiscal '21, or could it be earlier than that?

Jason P. Rhode - Cirrus Logic, Inc. - CEO, President & Director

We could see some contribution before that, but it's -- that's probably a reasonable placeholder for when the potential is for it to be meaningful. It is one of the further out things on our delay as to our growth strategy. I think, obviously, the short term is being driven significantly by progress in amplifiers and haptics in particular, broadening out our penetration into more and more the Android ecosystem. Increasingly, we feel like haptics is a really good poster child for where we can take our audio technology and imply it to other areas that maybe aren't as audio and voice related, but that mixed-signal capability to embed high processing power in an integrated mixed-signal device maybe with higher voltage capabilities is a little bit unique and something we're seeing a lot of pull forward from the market. So we remain really excited about voice biometrics, but as you pointed out, it's further out in some of these other growth factors for us. Feedback from customers has been good. We've done a number of demos with various interesting customers for the technology and continue to look for ways to broaden out the appeal into other devices. Obviously, we're targeting handsets first, but there's a lot of interest in it for other markets as well.

Operator

Your next question comes from the line of Matt Ramsay of Cowen.

Matthew D. Ramsay - Cowen and Company, LLC, Research Division - MD & Senior Technology Analyst

I guess, guys, maybe you could talk a little bit about -- you had given some commentary over the last couple of quarters about visibility to returning to growth in fiscal '20. Maybe you could just expand on that a little bit, if that's definitely still the case and a forward commentary would be helpful. There's just a lot of moving parts here from a macro perspective, which don't really affect the wireless market per se. But I just want to make sure we have things calibrated?

Jason P. Rhode - Cirrus Logic, Inc. - CEO, President & Director

Sure. Yes, we -- I mean, so just to be clear, we don't have any magic crystal ball as it relates to the macro situation and trade wars and all of that. So that -- the commentary about return to growth is definitely not reflective of us being overly rosy as it relates to what the general market is going to do. But it is reflective of content gains that we expect to see with customers we already have. We do expect in the Q4 time frame to get back to having a second customer that is north of 10%. So I feel the challenge, everybody is going to have to pay attention to more than one customer of ours. But we're excited about that, and that should drive a good result for us through the year. So the return to growth is really based on things where we know what we're shipping and we know the content we have and the content gains that are associated with that, the progress the team has made penetrating an increasing number of accounts in China, some of which are smaller and we have to aggregate up a larger number of wins, but some of which are not so small either in China or Korea. Just to highlight the comment from last Shareholder Letter, we were pretty



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excited to be now shipping to the top 3 handset manufacturers overall. And we've been -- as we kind of alluded to earlier, we made some progress with some of the bigger guys in China. So that's what the guide or the outlook, I guess, I should say, for FY '20 is based on. There's not any miraculous growth in the market or a rosy outlook in that perspective. This is based on content gains and continued expansion.

Matthew D. Ramsay - *Cowen and Company, LLC, Research Division - MD & Senior Technology Analyst*

Got it. Got it. That's helpful. And then, I guess, as a follow-up, completely unrelated, one of the -- a couple of the trends we've been following in smartphone space are, I guess, OEMs push to just have completely flat glass faces with no real holes or buttons and additional wrinkle of potential folding phones and flexible phones and the like coming down the pike. Maybe you could talk a little bit about some of the challenges around audio from microphone and speaker placements, et cetera, for some of those type of designs. Is that area of R&D that might differentiate your product? Do you see that as a driver? Or am I sort of going down a rabbit hole I shouldn't be going down?

Jason P. Rhode - *Cirrus Logic, Inc. - CEO, President & Director*

No, I think that is already a driver of a lot of what we're doing, particularly as it relates to the boosted amplifiers and then also in a different way to some of the haptics that we're investing in. So the analogy I always use is probably the members back when they're in college and they had a cheap set of stereo speakers that were the size of a refrigerator, but they sounded pretty good. It's easy to make things sound good when you've got big speakers and lots of air to move around. But as things get really compressed, it seems like the acoustics folks are always left in line when it -- when space in a handset or volume in a handset or microphone or speaker placement is decided, it's always the idea you guys got to first and get what they need. And so it becomes increasingly difficult to make these handsets and other products sound good as they get smaller and have less air to work with or less ideal placement of the transducers, either on the input side or the output side. So that's a lot of what we've done with the boosted amplifiers, for example, just trying to make them sound -- continue to sound good and especially be louder in an environment where the speakers get smaller and the air volume they have to work with get smaller. So I -- you're spot on that, that's already driving a meaningful amount of the business for us for the boosted amps, and it's certainly an area that we're investing in to try to make such things better and better and especially louder over time.

Operator

Your next question comes from the line of Rajvindra Gill of Needham & Company.

Rajvindra S. Gill - *Needham & Company, LLC, Research Division - Senior Analyst of Microcontrollers, Analog & Mixed Signal; Consumer IC & Multi-Market*

Congrats on the good execution on the boosted amplifier. So staying with that theme, can you talk about the share shifts that are happening in the amplifier market, particularly the Android market, your competitive advantage there? And the fact that you are ramping with more models, how do we think about that as the total TAM and as a growth driver going into next year?

Jason P. Rhode - *Cirrus Logic, Inc. - CEO, President & Director*

Sure, yes, so let's -- it's a key part of our growth. Well, it has been a key part of our growth over the last however many years since we got into that market. We definitely expect it to be a meaningful part of the growth through shipping amplifiers to folks we haven't shipped amplifiers to previously. It's a little bit of a mix of taking share from other suppliers or competitors of ours and also selling amplifiers into -- in the handsets that either didn't have an external boosted amp at all or just had a basic amplifier that was built into, say, a PMIC or so forth in some of these chipsets. So as these -- kind of to the question earlier to the point that we were making there, it's gotten harder to either maintain the amount of output volume that you've previously had and also there is a real desire to have them be much louder in the first place. People have as a use case they'd really like to be able to set the handset on the passenger seat of the car and use the speakerphone without monkeying around with a bunch of Bluetooth and trying to get everything to work right to set the phone down and use it in speakerphone mode. And that really does need to be pretty loud to pull

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off. So that's why you've seen the migration to boosted amplifiers and then also the addition of stereo, which yes does provide some degree of stereo separation. But in large part, it's about just making the overall handset to be make much louder. So specifically to your question, it's a bit of growth through addition of -- to separate boosted amps that didn't have them before, the change to stereo and some that's come at competitors' expense, some of it's come via devices that just didn't have this product in them before at all.

Rajvindra S. Gill - *Needham & Company, LLC, Research Division - Senior Analyst of Microcontrollers, Analog & Mixed Signal; Consumer IC & Multi-Market*

And we're seeing some Chinese OEMs start to adopt voice activation, voice trigger for -- that includes always-on voice. What's your positioning there? It seems that's a market where there's going to be a need for always-on ultra-low power voice processing?

Jason P. Rhode - *Cirrus Logic, Inc. - CEO, President & Director*

Sure. Yes, we agree, and that's certainly an interesting trend. We expect to benefit from that. Certainly more voice activation means that you need to be even more conscious about power than handset manufacturers already are. So that creates good opportunity for us. We're certainly shipping some of those models today. Generally speaking, it's a little higher end play. And therefore while the flagship ones have got a lot of panache and flash to them, they maybe don't drive as big of a business as the amplifiers might over time, simply because, well, not everybody wants to differentiate on some of these more esoteric speakers -- sorry, esoteric functions. Everybody wants it to a better phone and a better handset and a better speakerphone. And so I would say the still and rank order, the amplifiers and haptic are probably a bigger -- we expect them to be a bigger driver of revenue growth in the China market over the near term.

Operator

Your next question comes from the line of Blayne Curtis of Barclays.

Blayne Peter Curtis - *Barclays Bank PLC, Research Division - Director & Senior Research Analyst*

Jason or Thurman, I was just curious, you haven't updated the fiscal guidance a few quarters here. I think December is down a little over 20%. So just if you have any thoughts -- I know you talked about Android win. But is there any update for the fiscal guide? That's question 1.

Jason P. Rhode - *Cirrus Logic, Inc. - CEO, President & Director*

Yes -- a lot of this -- I mean, yes, December is down significantly, but that's because Q3 was kind of a significant beat. Again, the sum of the 2 quarters, Q2 plus Q3, is largely in line with our previous expectations and I think pretty consistent with consensus. As it relates to Q4, there's a lot of moving parts in that time frame. I would say whenever that happens, we like to be really conservative. And so I would say in that context, maybe consensus is a little bit higher relative to what -- if we had our druthers and we were drawn up everybody's models, we'd probably lower that a bit just to give ourselves a little bit of space. But there's a lot of moving parts between now and then. The primary drivers, as I said in the opening remarks, are just end customer handset demand, which we don't necessarily know yet. And then also in the Q4 time frame, we expect to get back to having a second customer that's over 10%. And so the timing of that launch is -- also add some variability as it relates to Q4 versus Q1 of FY '20. And so those are kind of the remaining bits of variability. And given all of that, we would just, as usual, try to be conservative and maybe drop it a bit. But any range of things is possible. I think depending on how things go, we could potentially be significantly higher or we could potentially be significantly lower, maybe not lower than your number for consensus.



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Blayne Peter Curtis - *Barclays Bank PLC, Research Division - Director & Senior Research Analyst*

Excellent. You did mention -- you did talk about a little bit, but I wanted to just follow up on haptics. You mentioned taping on a specific part for it. Can you just walk us through the competitive landscape for haptics drivers and then your visibility in maintaining the stock as you have? And then where do you see opportunities for this new chip?

Jason P. Rhode - *Cirrus Logic, Inc. - CEO, President & Director*

Yes, it's been pretty -- the concept has been pretty well received. I would say that the device we already have has been tremendously well received. It's Korea, it's China, it's really end-to-end, as we mentioned in the release, North American customers are interested in it. The competitive landscape is pretty limited at the moment. Because of the needs for ultra-low latency and some of the other real kind of nitty-gritty details, it's really helpful to have the DSP integrated into the amp. And so that's less -- if I think about our audio amp competitors, that's more in the NXP wheel house versus Maxim. Maxim stuff generally is the amplifier by itself and you need to do the signal processing elsewhere. And there are certain customers for whom that's an appealing architecture. But for haptic, given the ultra-low latency and the feedback, it's really helpful to have the integrated DSP. So that kind of narrows it down a little bit to us and NXP. TI has got some products that are out there. It doesn't seem like all of our competitors are focused on it early enough. It is, I think, the case that certainly one of our amplifier competitors had a bit of a circus going on over the past couple of years on the M&A front, which I think maybe had their eye off the ball in this particular market. But yes, it's a very compelling opportunity, and I'm certain everyone else won't ignore it. But at the moment, it's -- that isn't the primary concern. We roll in with customers. They -- our customers worry about, well, if I go to a proper haptic actuator, that does add cost not through our chip so much as just a good haptic actuator is more expensive than an old school vibration motor provides a completely night-and-day different experience, but not everybody in the Android space is willing to pay for much of anything. But nonetheless, we're seeing kind of customers across the board are very, very interested in it. And then that just leaves us to try to address things like overall system costs through integration of more of the capability -- more of the things that are needed on the boards, lowering passive component cost, being able to do more in DSP such that you can use a less expensive haptic actuator. Those are kind of some of the competitive trends in that space.

Operator

Your next question comes from the line of Christopher Rolland of Susquehanna.

Christopher Adam Jackson Rolland - *Susquehanna Financial Group, LLLP, Research Division - Senior Analyst*

Just quickly on the second customer over 10%. Are you providing them enhanced or better features that you're already supplying? Or are these totally new features for that customer?

Jason P. Rhode - *Cirrus Logic, Inc. - CEO, President & Director*

It's kind of new functionality for us to ship them.

Christopher Adam Jackson Rolland - *Susquehanna Financial Group, LLLP, Research Division - Senior Analyst*

Excellent. And then on amps, if you win one amp, are you typically winning all of the amps and haptics in that phone? And then also, the amps that you're shipping now, kind of where are we in the 55-nanometer ramp? It kind of reads like a lot of the amp points that you have might have been older stuff, is that right?



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Jason P. Rhode - Cirrus Logic, Inc. - CEO, President & Director

Well, look, I'll try to do that in the reverse order. The Intel -- we didn't have this new 55-nanometer amp with the integrated DSP for the Android market. We didn't have that until about a year ago. So certainly some of the wins in Android were with 1 or 2 of the older devices, but frankly, they really weren't architected that well for Android. So we've really seen an uptick in Android design-ins following the launch of the 55-nanometer part with the integrated DSP. I forgot what your first question was. Sorry, my correct team of IR professionals reminded me the first question was,, do we usually win the -- both of them. I'm unaware of any case where -- if somebody is actually doing stereo where the amplifiers will get split either -- even among models of our own amps, let alone across 2 different vendors. That would really be complicated to manage. There are cases where customers do what we call receiver-assisted stereo, which means they use a traditional receiver speaker for the earpiece like when you hold the phone up to your head kind of speaker. And they'll play -- they'll filter out the base and play a little bit of the high-frequency stuff through that in the speakerphone mode to try to give you a pseudo-stereo experience. And in that case, we would only have one amp, but it's a pretty uncommon solution today. The haptic isn't necessarily connected from one competitive -- in a competitive situation. But certainly, the more content you're shipping, that gives you a lot more opportunity. Most customers really like to have as few throats to choke as possible when it comes to developing new products. So if we're winning the stereo amplifier SoC, I would say that gives us a leg up on the haptic slot and else and vice versa. But they're not as directly connected as the stereo amp pair.

Operator

(Operator Instructions) Your next question comes from the line of Adam Gonzalez of Bank of America Merrill Lynch.

Adam Gonzalez - BofA Merrill Lynch, Research Division - Research Analyst

Just need certain disclosures. It looks like revenues outside of your largest customer implied down mid-teens or so year-on-year. And this is despite easier comps from last year. Just wondering if you could remind us why that's still the case and when we can expect this to be rebound? Is it when that second 10% customer comes back online Q4? Or could it be before that?

Jason P. Rhode - Cirrus Logic, Inc. - CEO, President & Director

Yes, that's the dynamic. It's largely related to that same customer, and it's difficult to really get any visibility about it, given that they're not currently a 10% outfit. So yes, it's largely related to that, related to some of the larger Android customers that we've had who have had the most superb past couple of years, which has been a little bit of a challenge there.

Adam Gonzalez - BofA Merrill Lynch, Research Division - Research Analyst

Got it. And then just my second question. Can you just talk about some of the progress you've made in digital headsets? Just remind us what some of the milestones you've met and anything that's on the horizon that we should be looking out for?

Jason P. Rhode - Cirrus Logic, Inc. - CEO, President & Director

Well, we're shipping in more models. It seems like a new one here and there over time. It really -- the Android space did not rush to the adoption of the USB-C only or drop a headphone jack nearly as quickly as we thought they might. We do have some thoughts that in the -- over time, the 5G transition might actually impact that a bit, because it does get pretty complicated from an antenna and radio perspective. And turns out, at those kind of frequencies, having analogue ports in your phone and in particular wires that are 3 meter -- 3 feet long, sticking out is not great from an antenna perspective. So we might see some catalysts there as that category of customers figure out like why that actually mattered a number of years ago. But it has been slower to progress than we expected. But nonetheless, we remain feeling pretty good about the product line that we've got and the offerings that we've got out there, which are broader than they've ever been. And we are seeing good uptake of that from the

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customers that are choosing to launch such products. So it's probably, I would say, relative to expectations a year or so ago, amps and haptics are better than our expectations in that time frame and headsets probably a little bit lower, but we're still working on trying to shore that up.

Operator

And your last question comes from the line of Charlie Anderson of Dougherty & Company.

Charles Lowell Anderson - *Dougherty & Company LLC, Research Division - VP and Senior Research Analyst*

Jason, I think we're starting to see a few Chinese OEMs adopt these so-called smart mics with a single DSP core, I guess, voice wake, voice activation sort of the thought there. I'm just sort of curious, over the long term, where you see that trend and the interplay between that and the codec, what capability they're looking for from the codec versus what they want to do out with the mic, although I know you certainly have a mic business and will participate to some degree. So just long-term trend architecturally, what are you seeing there?

Jason P. Rhode - *Cirrus Logic, Inc. - CEO, President & Director*

Well, frankly, that architecture doesn't make a lot of sense to us and the feedback we've gotten from most of our customers, it doesn't make a lot of sense for them either. In most of these cases where you are wanting to do any of that voice activation function, it's not a single mic system. And so why you would embed the DSP content there where it actually -- there is no value particularly in adding it there, I suppose unless you don't have a chance of winning the codec. So I would characterize the wins that we see in that business for them is -- are really pretty niche and to develop something in 55-nanometer to go after opportunities that size also to us. We have made a lot of progress on the microphones. We do see a lot of opportunity to innovate in mics and turn them into something that's far more -- far less of a commodity product, but it's not along those lines in particular. I mean, again, there's always an interesting niche here and there. It's a pretty broad market and so forth. But it's not a major driver that we're likely to go pursue, at least not as far as the way they've differentiated that particular product.

Operator

(Operator Instructions) And there are no further questions in the queue. I return the call back over to Chelsea Heffernan.

Chelsea Heffernan - *Cirrus Logic, Inc. - Director of IR*

Thank you, operator. There are no additional questions today. So I'll turn the call back to Jason.

Jason P. Rhode - *Cirrus Logic, Inc. - CEO, President & Director*

In summary, we are pleased with our accomplishments in the September quarter as we ramped shipments in numerous new devices and expanded our footprint in Android. With a robust portfolio of products and innovative road map, we believe in our ability to expand our share in our target markets and return to year-over-year revenue growth in FY '20.

I would also note that we will be presenting at the Nasdaq's 39th London Investor Conference on December 4. A live webcast of the event 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. Goodbye.



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