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CRUS - Q1 2020 Cirrus Logic Inc Earnings Call

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OVERVIEW:

Co. reported 1Q20 revenue of \$238.3m and GAAP EPS of \$0.08.



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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by. Welcome to the Cirrus Logic First Quarter Fiscal Year 2020 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 call over to Mr. Thurman Case, Chief Financial Officer. Mr. Case, you may begin.

Thurman K. Case - *Cirrus Logic, Inc. - VP of Finance, CFO & Principal Accounting Officer*

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 first quarter of fiscal year 2020 at approximately 4 p.m. 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, 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 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 the current expectations.

Now I'll turn the call over to Jason.



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Jason P. Rhode - Cirrus Logic, Inc. - President, CEO & 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 delivered Q1 FY '20 revenue of \$238.3 million and GAAP and non-GAAP earnings per share of \$0.08 and \$0.35, respectively. Q1 FY '20 sales were at the high end of guidance due in part to the success of recently launched products that utilize our components.

During the quarter, the company continued to experience strong design momentum with new and existing customers across our product portfolio. We are delighted to be shipping with 7 out of the top 10 smartphone OEMs and expect more devices incorporating our solutions to be incorporated over the next 12 months.

Moving forward, the company remains focused on delivering long-term growth through investments and innovative products targeting audio, voice and other adjacent markets where we can leverage our expertise in low-power, low-latency signal processing.

Before we begin the Q&A, I would 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 relationship.

Operator, we're now ready to take questions.

QUESTIONS AND ANSWERS

Operator

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

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

Congratulations on the results. First question. Jason, you made reference to a new smart codec in your Shareholder Letter. I was just hoping you could elaborate a little bit on that particular product. And is this is something that you're shipping to pretty much all your customers at this point?

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

No, no, that's -- thanks for the question. No, that's a targeted custom product. So no, it's not a broad market device.

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

Very good. And my second question is, you're guiding your gross margin to be up sequentially. Seasonally, obviously, smartphone tends to be a higher percentage of the mix, so I'm surprised the gross margin is going up. Can you maybe elaborate a little bit what's going on there? Is it more your own cost controls? Or you're actually starting to see some benefits of price as well?

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

It is certainly our own efforts to contain product costs. There's mix. There's a bunch of moving parts to it. So we're certainly pleased with that outlook. From a margin perspective, we think our model obviously works at margins lower than that and so we would certainly be supportive of taking -- of growing up revenue in a way that could conceivably not be that -- as high as what we're guiding for the current quarter, but we think that's a great result. Just a testament to a lot of great work from a bunch of our folks, from the folks designing new products, making it more efficient as

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well as supply chain and other teams doing their jobs well. So yes, pleased with the result, and we'll just kind of take it quarter-by-quarter as we go from here.

Operator

Your next question comes from the line of Christopher Rolland with FID (sic) [Susquehanna Financial Group].

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

Congrats on strong results and guidance. Let's see, in the presentation around headset codecs, just looking for maybe a little bit more color here. You mentioned a bunch of different functions. You mentioned USB audio, DSP, continually adaptive ANC and hi-fi DACs. Are we to think that all those are in the codecs that you're going to be shipping soon? Or are there some functions that are eliminated from those?

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

That's a great question. I appreciate it too because that does seem to be a common source of speculation out there. So it's good to be able to clarify what we mean. So we're -- that just is intended to highlight the types of value we're providing across-the-board in headsets. So not necessarily all of them. We have USB-C type codecs that support noise canceling, we have USB-C type codecs that support a more basic headset functionality, digital headset functionality. We have smart codecs that are shipping today, we're launched in wireless -- what we call truly wireless earbud-type devices that were launched this spring, so we're excited about that. That's been a really popular design win that we've been chasing supply throughout the bulk of last quarter, and we expect good things to continue to happen with those particular bud devices. So -- and then we're -- we have additional content that we can provide. Again, you need at least microphones, amplifiers, in some cases, codecs -- in every case, a codec somewhere. You can need noise-canceling in USB. We're very excited about the wireless form factor. We think that's kind of one of the steady drumbeats that we've got is our participation in new products that we haven't been in historically. So I think as we referred to in the Shareholder Letter, we expect to be in additional very popular wireless untethered earbuds later this fall, so we're excited about that. And that puts us -- we expect that'll put us in a couple of the most -- very most popular products of their type out there, so we're excited about that. So just to be clear, since it kind of pops up now and again, there is content other than ANC that we can provide these devices. We don't license our ANC to other folks. Our ANC is typically targeted at very high-performance, high-noise cancellation type environments. So that isn't necessarily -- not that there's not interest in noise-canceling in the untethered buds kind of products. There certainly is, generally speaking, given the battery constraints. It would likely be a lower-performance-type solution, but that's fine. There's other opportunities for us to gain content in these type of sockets, whether it's codecs, amplifiers, microphones, or in the case of wired ones, the USB-C stuff. So good product lines. It's taking longer to develop than we maybe would have thought, but we're definitely on the cusp of some good things happening.

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

Understood, and congrats on that win. In the presentation, you mentioned \$1.3 billion in other edge processing in 2023. And that seemed like it was different from smart home or autos or wearables. Just wanted to be clear, what we're talking about there. What comprises that, either in end markets or end devices or your products?

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

Sure. Well, so -- I mean, edge processing, as the name sort of implies, is heavy-duty signal processing that we want to do at ultralow powers -- ultralow-power in the end device. So rather than some competing solutions that could be implemented, for example, in the cloud, voice biometrics is a good example of that. So there are solutions that are on the market today for different functions, call centers and so forth, where they identify you via your voice, but that's done with a really heavy server-grade kind of signal processing done in a cloud somewhere. That's not what we're targeting. We're targeting being able to do these types of functions on ultralow-power, always-on battery-enabled devices, handsets and other things. So voice biometric could certainly be applications like speech recognition or other kinds of audio or voice enhancements that are embedded



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in that. So all manner of signal processing that is done locally, low-power, low-latency, it's kind of the thing that puts it in our wheelhouse. So we're really -- I mean, it's a big market today, but we see no end of the expansion of that over the next handful of years as well.

Operator

Your next question comes from the line of Charlie Anderson with Dougherty & Company.

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

Congrats on the result and some of the design win traction. Wanted to just start with maybe the big-picture question, Jason, just sort of addressing the year. I know you don't guide formally. But may just any qualitative thoughts on how we should think about the year. And then I've got a follow-up.

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

Sure. So I mean the good news -- we're getting through the year-over-year comps where we're kind of lapping much-discussed dongle inclusion or lack thereof. So that's -- from a year-over-year perspective, that's good. Obviously, we don't have insights about who's going to turn up and buy what handsets when they're new and being launched. So that's what it makes it difficult for us to provide quantitative guidance in that regard. But from a qualitative perspective, we're pretty excited about things as time goes on increasingly. So there's a pretty steady drumbeat. We talked about continued growth with our audio amplifiers. In haptics, we think we see good opportunities, as I mentioned on our previous question, to continue to expand our business in the untethered earbud-type devices. So that's exciting. We're poised to grow our business in tablets, which is meaningful. It hasn't been a form factor. We've had a lot of participation in for significant amount of time, so that's a pretty meaningful share that we expect to take there. We expect to continue to grow longer term in other wearable-type devices. That's a market that we've had some participation in, but we've been seeing that kind of on the horizon for a while, and we've got the devices out there and feeling very good about the expectations and the plans of record around our products for wearables. And then longer term, kind of just opportunity that we don't get into too much detail just because of the nature of who we're engaged with, but suffice to say, content we've not provided previously for functions that we've not addressed previously for some of our high-volume handset opportunities kind of in the roughly year from now time frame. So we see a steady drumbeat of increased content in all of the devices that people care about and matter and are clearly driving volumes for some of the world's best customers. So we're pretty excited about what that means qualitatively. Again, in this environment, I think it's not best for us to be guessing about how many people are going to turn up where and buy what handset. But qualitatively, the story's really good.

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

Great. And then for my follow-up. I think you've mentioned now for several Shareholder Letter's that there's adjacent market and there's good customer interest there. You haven't named the product or the capability. But I guess, what I would be curious in is, would this be a merchant product? Or would this be a more of a custom -- by customer type of a product area?

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

Well, we -- I mean we tend to talk about the things that are for the broad market, we are a little more -- we're a little less cagey about those, I guess, I would say. We try not to get too far ahead of our skis no matter what it is. But in this case, you're referring to what we very helpfully referred to as a closed-loop controller. It's just kind of a follow-on to -- we started with audio amplifiers which became interesting for us once there started to be a lot of signal processing embedded in the amplifier involved with monitoring and voltage and current being delivered to the speaker to do protection and enhancement and other types of functions. That led us to really look at where else could we deploy that, which led to the haptic opportunity, which is quite similar to audio amplifier. So this new stuff that we're addressing is again further types of what we're referring to as closed-loop controller technology, very low-power, low-latency signal processing, but for other applications within some of the highest volume



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devices that we sell into. And so it's good content that we expect to see in kind of the roughly a year -- a little over a year from now kind of time frame. So details of what that is and whatnot, obviously, we don't get into ahead of when they're launching.

Operator

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

Ethan Jeremy Potasnick - Cowen and Company, LLC, Research Division - Research Associate

This is Ethan Potasnick on for Matt Ramsay. I was wondering just big picture, little while back, you guys expecting a third 10%-plus customer. I was wondering if you guys could discuss given certain trade-related dynamics and the corresponding uncertainty regarding with who and what components are permitted to be shipped. How that picture is kind of shaping up to look like?

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

Sure. So we're talking -- I think in the context of Huawei last quarter -- as recently as last quarter, we're talking about the long-term potential for them to be a 10% customer. We think that's potentially still the case. We've gone through the same drama that I think is everyone seen play out in the news already that SIA and politics and all those so forth. So initially, we did shut down shipments, worked with our export council, certainly reviewed the assays, findings and so forth. So determined the types of silicon we saw, we can resume sales there. Just to note, we're not in 5G-type stuff. We're not in network equipment. It's handset-related stuff. So we don't see any -- certainly, our view is there's not some strategic threat posed by the sale of very low-power audio amplifiers or handsets. We filed for export license among -- in the very first days of that saga coming down the pipe. So we would hope if the rhetoric is true that we would hope to be among the early ones to get a license to do that, but obviously, it's not under our control. So I think in the short term, the very good news is they were not currently a very big customer at all. We were pretty pleased with the progress we've made in cultivating them as a good long-term customer. And hopefully, the politics will result in such a way that we can get back after growing that side of the business. We think it remains the case that we've got the most compelling technology of the type that we provide, and I think customers like that. They'll continue to rally around the solutions that we're able to provide. So I think the long-term story is that short-term impact is relatively minimal.

Ethan Jeremy Potasnick - Cowen and Company, LLC, Research Division - Research Associate

Got it. Okay. And I guess just as a follow-up, specifically with regard to your opportunity in voice biometrics. I was wondering if you could expand on some of the longer-term progress you're seeing in sampling? And then what kind of feedback you guys are receiving?

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

Yes. So a lot of interest in the devices. It was great to get the FIDO certification behind us. We're the first voice solution out there to receive that. That gives a lot of customers -- I think we'll give a lot of customers some comfort that if you implement our solution as intended that you're not going to be subject to class hacks and things like that that's the intent of that certification. So we're very pleased with that result and are out promoting it to customers. We've got people evaluating it, designing with it, giving us feedback. The feedback has been extremely positive that the capabilities of the device are very robust. It's a powerful technology that we see a lot of legs to. It's important to note that it's the first product of its type from us. Usually, for us to turn something into a big business, it has to be a product line, and we certainly see the probability of that in voice biometric being quite good over time. This first device that we're targeting is for handsets specifically, see the application and specifically for hands-free use of handsets. We see the opportunities for us in whatever it might be, whether it's headsets of various sorts or any other thing with a voice interface as being very compelling over time as well. Not necessarily the same solution, but based on the same underlying technology. So we see really good opportunities for us. We see good feedback and results. The FIDO thing was a great milestone, and the teams are doing a good job of just continue to chip away at that.



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Operator

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

Thomas James O'Malley - *Barclays Bank PLC, Research Division - Research Analyst*

This is Tom O'Malley on for Blayne Curtis. Really nice results, congrats. I guess my first one, in the release, you guys talked about MEMS mics and you specifically referenced working with the lead customer. I don't remember that language being in the prior quarter releases. Can you talk a little bit about that relationship? And is that going to be a significant contributor here in the near future?

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

We're still not telegraphing in the near term for it to be big revenue. We do -- we -- as you would imagine, you know, we target working with the best customers and in the order of importance. That the polls that we've had from customers for us to be a supplier in microphones, I would regard as very, very high, like really kind of surprisingly strong poll from customers wanting us to be successful in that space. The details of what we ship and when we need to be a little bit cagey about and certainly it is the case. As in most things we do, we want to be successful, we want to be reliable, we want to frankly ship in things that are -- ship in opportunities that are still with very critical customers, but in lower volumes first, we don't want to leap right them into the main stage. Microphones are hard. My hat is off to folks to make them successfully. But we think in the long run, we can do it better and more reliably and with the same kind of capabilities and timeliness that we do on the traditional silicon side. So continue to think that things are going to happen for that market with multiple customers that buy a north of 1 billion microphones a year. So we're not targeting making microphones for toys and other stuff. We're targeting premium mics that can command a reasonable margin if developed properly. So continue to think we're in good shape there.

Thomas James O'Malley - *Barclays Bank PLC, Research Division - Research Analyst*

Great. That's super helpful. And then my other one is really just around the Android business. Clearly, you guys had a lot of success with Samsung in the past couple of quarters, both on the amp side and the earbud side. And that's been a pretty significant contribution to that revenue. Outside of that, you guys have talked about being -- working with 7 of the top 10 Android guys. And then you also mentioned in the release, in terms of haptics next 3 to 12 months, you're going to see some more customers coming to market. When does that inflection point for customers outside of Samsung? And when do we see that revenue really turning up and impacting that bucket as much as we've seen that other customer Samsung being last 2 quarters moved the dial?

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

Well, there's not too many that is as big as the guys in Korea. So that's one thing. It does take aggregating up more and more base hits. We see good opportunities with our Korean customer base to continue to grow the product line there. It's not all -- as anyone that follows our industry knows, it's off -- that particular customer can be pretty unpredictable, but we've got a great relationship there and good opportunity over time to grow our content with other types of new devices. In the broader Android, in China specifically, or actually even in North America, we've got a couple of good customers in North America Android at this point. But the bulk of them out there in particular with the exception of the -- of our -- would be third-largest customer in the longer run. I'll let that, that you really do have to aggregate up a lot of wins to turn it into large dollar volume. So we see good progress on that front, but it isn't going to be a hockey stick type of growth curve there either.

Operator

(Operator Instructions) Your next question comes from the line of Raji Gill with Needham & Company.



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Rajvindra S. Gill - *Needham & Company, LLC, Research Division - Senior Analyst*

Congrats on solid momentum. A question on the amplifier market as well. Wanted to get a sense of kind of your traction in the China smartphone boosting amplifier market. You have a very compelling integrated DSP. There's been some small share that you've had in that market because of the overall weakness in the handset market in China. But wanted to see what your traction there is in China for midrange amplifier products.

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

Well, I guess, I would say that's the -- the new development press that's really contributed to the success in China has been amplifiers. They're of nearly ubiquitous appeal. Whether it's mono or stereo, we think the haptic solution in the longer run will be adopted pretty broadly there as well. Certainly, getting those 7 of the top 10 folks wouldn't happen without being amplifiers. Smart codecs have more limited appeal in Android just because it's such a cost-sensitive market. But everyone who makes a phone, wants their phone to be a better speakerphone, wants them to be louder potentially replace things like little micro speakers and so forth with just using your handset. So yes, it's been a big contributor to the progress we've made in Android during the past year, and we expect that to continue, again, both with audio and with haptic.

Rajvindra S. Gill - *Needham & Company, LLC, Research Division - Senior Analyst*

And on your voice biometric kind of the development, how do you think about the use of machine learning and neural network on the training side? And how important is that in enhancing your technology and providing more value with respect to noise cancellation? How are you able to leverage your machine learning and neural network capability when you bought that company Cipher a few -- a couple of years ago?

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

That's a good memory. Yes, it's a good memory, that's exactly why we bought them. There were directly bolted into the voice biometrics team. Currently, although we see the potential for machine learning to really have a significant impact for us in the long run, both as an algorithm implementation and in of itself or used as a training mechanism to tune a traditional algorithm. Really, it has the potential to be a big deal and it dovetails really nicely into the very low-power, low-latency signal processing that we already deliver. So yes, that's worked out well. It's a great team. They're, like I said, plugged in directly to developments that are really important to us. So that's kind of well overall.

Operator

And your next question comes from the line of Adam Gonzalez with Bank of America Merrill Lynch.

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

Congrats on the solid results and execution. Just first question on Samsung. Can you talk generally about the ramp that you expect to see there throughout the year? Just trying to figure out what the peak quarter would be? Will it be Q2? Was it Q4 last year? Or just generally, what your thoughts are?

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

Well, I mean, relative to that customer's flagship, of course, there's kind of 2 big ones. I think the timing of those are pretty well-known. We usually participate in both of those in a meaningful way. So that timing I wouldn't expect to change. We have done better job over time of penetrating other devices. We talked about the wireless buds that started shipping earlier this year. Of course, that lined up with the flagship launch, but that device seems to have some pretty strong ongoing opportunities. So hopefully, that maybe smooths things out a little bit. And then two, we've had more success over the last couple of years in penetrating some of their mid-tier sockets. And those a little bit less -- those are smaller volumes and



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scattered throughout the year, a little less dramatic kind of launch ramp-type situation. So again, that might help soften some of those peak quarter versus the rest of quarter (inaudible) type timing situations.

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

Got it. That's helpful. And then I know you can't really speak much about your largest customer. But just wondering if you exclude the whole dongle fiasco from last year, how would you characterize your visibility heading into the second half of this year versus a more normal cycle?

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

I mean our visibility is and has been very good at that account. It isn't something we get into a lot. The question is just however many people turn out to buy which product, which we, of course, don't ever really a great crystal ball for. But we're in the bulk -- well, we're in everything from handset perspective and increasing our penetration elsewhere. So I'd say, a great relationship as we prefer to and obviously about the best customer you can possibly have to have. So continue to see good things happening there.

Operator

(Operator Instructions) And there are no further questions at this time. I will now turn the call back over to Ms. Chelsea Heffernan.

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

Thank you, operator. There are no additional questions, so I'll turn the call over to Jason.

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

Thank you, Chelsea. Yes, in summary, the June -- in the June quarter, Cirrus Logic continued to broaden our penetration to flagship and mid-tier smartphones while executing on new product development and strategic initiatives that we believe are critical for long-term growth. With the differentiated product portfolio, commitment to design and supply chain excellence and increasing demand for innovation in the markets we target, we are optimistic about our future. I would also note that we will be hosting our Annual Meeting of Stockholders on Friday, August 2, presenting at the Oppenheimer Technology, Internet and Communications Conference in Boston on August 6 and presenting at the KeyBanc Capital Markets Annual Technology Leadership Forum in Vail on August 12. Live webcast of the conferences 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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