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CBS Outdoor Americas, Inc. (CBSO)

Q3 2014 Earnings Call

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CORPORATE PARTICIPANTS

Gregory Lundberg
Senior Vice President of Investor Relations

Donald R. Shassian
Chief Financial Officer & Executive Vice President

Jeremy John Male
Chairman & Chief Executive Officer

OTHER PARTICIPANTS

Marci L. Ryvicker
Wells Fargo Securities LLC

Davis s Hebert
Wells Fargo Securities LLC

Tracy Young
Evercore Partners (Securities)

MANAGEMENT DISCUSSION SECTION

Operator: Please standby, we're about to begin. Good day, and welcome to today's CBS Outdoor Americas' Third Quarter 2014 Earnings Release Teleconference. At this time, it's my pleasure to turn the conference over to your host for today's call, Gregory Lundberg. Please go ahead.

Gregory Lundberg
Senior Vice President of Investor Relations

Good afternoon, everyone. Thanks for joining our 2014 third quarter call. On the call today are Jeremy Male, Chairman and Chief Executive Officer; and Donald Shassian, Executive Vice President and Chief Financial Officer. After the prepared remarks, we'll open up the lines for question-and-answer session.

A slide presentation to accompany today's call can be found in the Investor Relations section of our website at cbsoutdoor.com, along with the earnings release and an audio webcast of this call.

This conference call may include forward-looking statements, and relevant factors that could cause actual results to differ materially from those forward-looking statements that are listed in our earnings release, in slide number two of the presentation, and in our SEC filings.

In addition, on this call, we'll refer to certain non-GAAP financial measures. Please refer to the appendix of the slide presentation, our earnings release and our Van Wagner acquisition slide presentation for the reconciliations of non-GAAP measures to GAAP financial measures, each of which can also be found in the Investor Relations section of our website at cbsoutdoor.com.

These documents provide reconciliations of results on a comparable basis, which, we believe, present a more meaningful view of our business performance and progress, by making certain adjustments to our reported results.

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And with that, I will now turn the call over to Jeremy.

Jeremy John Male

Chairman & Chief Executive Officer

Thanks, Greg and good afternoon everyone. Let's begin on slide four of the presentation, which is the key highlights of the third quarter. Back on September 10, we announced weakness in national advertising unfolding for the third quarter, and that our total revenue expectation was close to flat. As you can see here, that's exactly what we experienced.

Once again, we saw a positive performance in our local business, but national was down year-over-year. On the positive side, we're pleased to report that our international business added two points of revenue growth this quarter.

Now, we're obviously not satisfied with this level of revenue growth, especially with our relatively high fixed cost structure. As we've said before, with natural cost increases, we need to see revenue growth of around 1.5% to 2% to maintain our OIBDA. As such, this quarter's revenue growth translated into slightly weaker OIBDA, and accordingly, AFFO during the quarter.

In the context of these results, I'd like to take a minute on our view of conditions in the advertising market. When we look at the source of all of our revenues, our advertising clients, there's a significant stability on an annual basis, but there can be considerable variability quarter-to-quarter, based on campaign timing.

As of the third quarter 2014, on a trailing 12-month basis, some of our better-performing large verticals, in terms of overall revenue contribution, were healthcare and pharmaceutical, professional services and television. Conversely, at the bottom of our results were telecom, beer and liquor, and financial services. There's been a lot of discussion about whether results in the market, including ours that we're reporting to you today, are a result of a softer advertising climate or a media share shift to online. Let's address both of these.

On the ad market, there's definitely a disconnect between the recent economic news and what we're seeing companies spend on marketing and advertising. We know and can see that our clients are spending less. There was some third-party research published last week that looks at the quarterly financial reporting thus far of some top U.S. advertisers. In the first three quarters of this year, the median growth rate of these advertisers was zero to 1%. Last year, it was 6% to 9%.

Data like this supports what we've been seeing over the last few months. This is also reflected in the spend of the major U.S. telecom carriers, an important advertising category for out-of-home. According to Kantar, their year-to-date spending through August is down 5.2% from last year. Interestingly, they've actually cut their online allocation by around five percentage points, so it's not all about a secular shift to online.

Later on this call, I'm going to discuss some of our strategies for growth, both for our company, and, indeed, for our industry. It's a very exciting time to be leading this change. Looking ahead, I can say that we really are at a brand new point as a company, literally. We launched our new brand, Outfront Media, into the marketplace on October 20. I'll talk to you more about that a little bit later on the call.

Our past year has been dominated by our corporate transformation. I'm pleased to report that we've come a long way. The initial debt offering, IPO, split-off, reconversion, Van Wagner acquisition and the launch of our new brand. We now have the ability to focus virtually all of our efforts on extending our leadership position in the out-

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of-home media market. We have the best assets, the best audiences, and the best people, and we're going to use them and invest in them to improve results for our clients and our shareholders.

So, before I come back on, I'd like to turn this call over to Don, who will now take you through our third quarter financials.

Donald R. Shassian

Chief Financial Officer & Executive Vice President

Thank you, Jeremy and good afternoon everyone. Before I get into our overall results for the quarter, I want to highlight two accounting matters that we addressed in the quarter. First of all, as you know, the exchange offer occurred in July, and effective July 17, we began operating in a manner that allow us to qualify as a REIT for U.S. federal income tax purposes for the tax year commencing July 17, 2014. We also announced on October 29, that we're paying the required earnings and profits purge in the fourth quarter.

In connection with being a REIT, the deferred tax assets and liabilities that are on our books due to the historical differences between book and tax, like tax depreciation versus book depreciation, need to be written off, as those assets and liabilities related to our REIT assets will no longer reverse themselves over time. Therefore, as required by GAAP, we have reversed those net deferred tax liabilities into income via a benefit of $232.3 million reflected on the income tax expense line of our income statement. I would like to be clear, this benefit of $232.3 million or $1.92 per share is non-recurring, is non-cash, and therefore, should be factored into your understanding of our quarterly and year-to-date results.

The second accounting item I want to point out is that we've revised our classification of capital expenditures on our interim statements of cash flows. Non-cash purchases of property and equipment were previously included within capital expenditures in prior periods. This revision is not material to previously reported interim or annual financial statements. It also has no impact on net income, the balance sheet or the stockholders' equity invested capital previously reported. Since the change is to capital expenditures, and therefore, does impact maintenance capital expenditures, the revision did result in a minor change to previously reported AFFO amounts.

Now, please turn to slide six; this slide shows you the impact of the tax benefit I described on net income, EPS, FFO and AFFO for the quarter. It also shows other one-time expenses such as the restructuring charge and Van Wagner acquisition costs, as well as what the taxes would have been during the year if we were a REIT for the entire year.

As you can see, our REIT comparable results were net income of $25.9 million, diluted EPS of $0.21, FFO of $70.5 million, and AFFO of $75.5 million. Those metrics are then compared to 2013 on a comparable basis.

Now, let's turn to slide seven for consolidated revenue and adjusted OIBDA. The revenues were essentially flat year-over-year, with Billboard flat and Transit & Other up slightly. Breaking this down graphically, the U.S. was flat and International was up 2%. On an adjusted same-site basis, which removes non-comparable revenues of $3.9 million, our constant dollar revenues were up 1.4%. $3.3 million of the non-comparable revenues are related to the Los Angeles street furniture business that we sold in the fourth quarter last year and the GameStop, which is a business that we exited in the second quarter of this year.

With 70% of our costs fixed and some increases during the quarter, our adjusted OIBDA decreased 3.6% and margins were down slightly to 31.8%. These adjusted OIBDA amounts adjust for $5.2 million of incremental stand-alone costs that did not occur last year. Our total stand-alone costs for the quarter were $7 million.

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Our U.S. segment results, which were 88% of our revenues during the quarter, are on slide 8. As I mentioned, total U.S. revenues were flat. And Billboards on a same board basis, year-to-date yields on both static and digital are up. During the quarter, however, they're down slightly. Positive yield growth remains an important driver for us, and we're working to maximize the revenue of each display and make sure that the display delivering the best audiences are marketed accordingly.

In terms of revenue mix, local advertising performed well but was offset by softness in national. Transit & Other grew just under 1%, which was a better performance relative to 2% decline in the second quarter. The year-over-year increase in the third quarter revenue of $0.5 million is after absorbing the $3.3 million revenue decrease on Los Angeles street furniture and GameStop businesses that I mentioned earlier.

As we stated before, once our revenue grows in excess of 1.5% to 2%, we'll be able to leverage our fixed cost structure to drive a multiple growth on adjusted OIBDA. We are continuing to analyze board by board profitability as well as pursuing process improvements on our order-to-cash cycle to improve our overall cost structure. We expect our operating leverage to improve shortly as we grow revenues in the future and achieve various cost savings.

Turning to international revenues shown on slide 9, revenues were up 2% on a constant dollar basis in the quarter with Billboards up 1.6% and Transit & Other up 3.5%. Looking at the regions in detail, Canada, which is just over half the revenue, was down approximately 1% due in part to certain advertisers in the packaged goods category. South America, however, was again up strongly and Mexico came back during the quarter as expected.

While the international revenue improvement was good, revenue was pressured by the geographic mix of one country versus another and by increased operating cost for billboard and transit leases and higher compensation and bad debt provisions.

Turning to slide 10, capital expenditures. Our spending in the quarter was $14.3 million, including $5.1 million of maintenance CapEx and $9.2 million of growth CapEx. During the quarter, we added 30 digital boards in total, including 20 digital boards in the U.S. and 10 digital boards internationally; 7 digital boards in Canada, and 3 digital boards in Mexico. This brings us to 113 digital boards for the year, putting us well in pace for our guidance of approximately 120 digital boards for the year. Our 2014 guidance for total capital expenditures remains $65 million. Please note that this includes approximately $3.5 million in the fourth quarter CapEx to implement our new brand on substantially all of our structures and size.

Please turn now to slide 11 for analysis of our FFO and AFFO. This slide shows both FFO and AFFO on a REIT-comparable basis to equalize a number of items: the impact of our non-cash deferred tax reversal, the impact of incremental standalone cost for both years, the impact of interest expense related to our January 2014 debt offerings, the impact of taxes that we would not have incurred if we had been operating as a REIT for all periods presented, the impact of Van Wagner acquisition cost in the quarter, and restructuring charges related to severance.

Adjusting for these items, REIT-comparable FFO was down 7.5% compared to last year's third quarter, and REIT comparable AFFO was down 9.7% for the same period. Like FFO, AFFO captures our maintenance capital spending and this way it's very similar to the free cash flow metric you may use to look at other media companies. With a high flow of OIBDA to AFFO, we expect improvement in AFFO per share as the revenue initiatives drive top line results.

Slide 12 shows our historical dividend as well as our announcement last week regarding our recurring dividend and our special dividend that represents our earnings and profits or E&P purging distribution. Our recent

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announcement of a $44.4 million dividend payment for the fourth quarter or $0.37 per share is payable on December 15, to shareholders of record as of November 18. This dividend payment of $44.4 million when annualized for three quarters, represents a payout ratio of 64% of our year-to-date REIT-comparable AFFO. This level does not yet include our expected top up dividend for 2014 to be paid in early 2015.

The dividend dates I just mentioned are a bit different from our historical timing due to our announcement of a special dividend for the E&P purging distribution of $547.7 million, which will be payable on December 31 to shareholders of record as of November 20. Shareholders will have the option to elect all cash or all stock subject to a proration based on a cash limit with approximately 80% of the dividend paid in stock and 20% paid in cash.

The cash portion of the E&P purge is approximately $109.5 million. CBS left us $100 million from the IPO to fund the cash purge and the balance of $9.5 million will similarly be transferred to us from CBS prior to December 31 to fund the balance of the cash purge.

One area I like to point out to you is a more thorough explanation of the implication of the purge on our shares and dividend going forward. The stock portion of the E&P purge will result in additional shares being distributed to our existing shareholders. This increase in shares outstanding on December 31 will not impact the absolute dollar amount of our dividends that are expected to be paid in 2015 and beyond.

However, due to more shares outstanding, the denominator, the number of shares, does change as will, therefore, the per share amount. We intend to continue paying a healthy REIT dividend that can grow as our business grows while also deleveraging to our target of 3.5 times to 4 times.

You can see our balance sheet profile on slide 13 as of September 30. We are very comfortable with our balance sheet strength and liquidity, which enabled us to pursue and acquire the selected assets of Van Wagner.

At quarter end, the weighted average cost of debt was 4.2% and our consolidated total leverage ratio was 3.9 times. Including $172 million of cash on hand, the net leverage ratio was 3.5 times. The liquidity position was $597 million including an undrawn $425 million revolving credit facility and $172 million of cash on hand.

You will also see on this slide the additional $100 million in cash from the net IPO proceeds which will be used for the cash portion of the E&P purge. I would also like to point out that subsequent to quarter end, we completed the financing for and closed our acquisition of selected assets from Van Wagner on October 1. This added $150 million to the 5.25% new notes due 2022 and $450 million of new 5.875% notes due 2025.

Our pro forma gross leverage for the Van Wagner acquisition when we announced the transaction back in July was 4.9 times based on the combined pro forma adjusted OIBDA as of December 31, 2013, on an LTM basis. As we indicated at that announcement, given OIBDA increases and also due to the $40 million of lower indebtedness than originally contemplated, our leverage, including the acquisition, will be lower than this original 4.9 times estimate. Our goal is to grow OIBDA, maintain a high dividend payment representing 100% of the QRS tax return taxable income, and use residual free cash flow to delever the balance sheet back down into the 3.5 times to 4 times range.

I'll now turn the call back over to Jeremy on slide 15.

Jeremy John Male
Chairman & Chief Executive Officer

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Thanks very much, Don. Let me just take a moment now to look at our business outlook for the fourth quarter. At this point, national trends in the fourth quarter look similar to the performance in the third quarter. Overall, our current revenue expectation for the fourth quarter, including the acquired Van Wagner assets, is flat to slightly down.

There are three important things to mention on this outlook. Firstly, this is at a point in time. Secondly, it's on a constant dollar basis. And thirdly, it also includes around $3 million that Don mentioned, relating to businesses that are no longer in our financials.

Now, let's talk about how we're going to improve these results as we look forward to the new year. The first key element is our new brand, Outfront Media. This brand name will guide everything we do. It's not just the sign on our boards. It's who we are and what we stand for; leadership and innovation.

A definition of Outfront is leading or ahead of the competition. It also means candid, frank, and honest. This is where and what we want to be. And the word media instead of outdoor is an intentional and conscious choice about the increasing importance and the impact of out-of-home in the broader media ecosystem. It's also a statement of where we're headed with technology, and I don't just mean continued investment in digital billboards. We're exploring and developing plans for new technology platforms to connect, transact, and interact with our advertising clients and their consumers.

Another key element of our growth will be our people who are recently expanded with some great new talent and leadership through our Van Wagner acquisition. We're investing in training throughout the knowledge and effectiveness of our sales team in a competitive and increasingly digital marketplace. An important aspect of this sales effort is elevating our national advertising strategy. While we've seen weakness in national advertising this year, we continue to believe that national advertising will be a key future source of growth for our industry.

The Van Wagner acquisition is certainly important enhancement of our platform for national advertisers and is a big step forward. We think there's increased value in the marketplace for these assets, and we're going to be particularly focused on this at buyer, agency and CMO level. We have an incredible premium suite of assets that can boost advertiser ROI, build brands, and generate sales.

And while we will be focusing extensively on national, our local sales team will continue to excel in their local markets. With good growth this year, local remains very solid, and we continue to believe that there are opportunities for both increased yields on our static boards and additional digital conversions.

As I mentioned in my opening comments, we're really at the starting point of our new company. It's been a busy year and we've accomplished many things. Not just the corporate activity as I mentioned, but also on the sales, operations and strategy side. We really are a new company. We're going to keep up this pace of activity to aggressively drive the industry forward.

We will be out front in technology, out front in thought leadership, and out front in innovation for our clients. As many of you have probably seen, the new logo imprints are going up on the boards and the company is 100% focused presenting our clients with great solutions that will ultimately benefit them and indeed, all of us on this call. We're going to be out front [indiscernible] (22:33).

And with that, operator, let's open the lines for Q&A.

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QUESTION AND ANSWER SECTION

Operator: Thanks. [Operator Instructions] And we'll take our first question from Marci Ryvicker at Wells Fargo.

Marci L. Ryvicker
Wells Fargo Securities LLC
Q

Thanks. I have a couple. I just want to clarify the flat to slightly down commentary. Is that just a pacing data point or is that guidance for the fourth quarter?

Jeremy John Male
Chairman & Chief Executive Officer
A

As we've said on the call, given the three comments I made regarding it, it is a point in time, and at the moment as we look forward, that is our expectation, Marci.

Marci L. Ryvicker
Wells Fargo Securities LLC
Q

Okay. And then do you have any political in the fourth quarter, or is that a non-event for you?

Jeremy John Male
Chairman & Chief Executive Officer
A

To be honest, it's somewhat of a non-event for us in terms of any real ad dollars, Marci.

Marci L. Ryvicker
Wells Fargo Securities LLC
Q

Okay. And then, looking at the quarter and backing out the $3.3 million negative impact from selling the transit shelters and then the non-profitable contract, organic growth was up 1.3%, better than flat. You spoke a little bit on what you can do longer-term, but is there anything nearer-term that you can do to push this further, that 1.3% is closer to 2%?

Jeremy John Male
Chairman & Chief Executive Officer
A

Well, look, we're working very hard, Marci. We're working – we worked hard in Q3, and we're working very hard in Q4. We continue to look at yields and how we can push pricing on our boards. It's fair to say that in our local markets that we still see considerable opportunity there for more closely aligning revenues that we achieve on each board to audience. There's a lot of legacy pricing in some of these markets and we think that with training and development, we will be able to sort of – we'll be able to push that forward.

And it's fair to say, we have had that general sort of more macro trend this year. Unfortunately, national advertising generally has not been as strong as we might have expected. And as that disconnect between sort of GDP growth and the general economy, and that dollar sort of rights itself as we go forward, I'd like to think that we can really be pushing those growth numbers up as we head into 2015.

Marci L. Ryvicker
Wells Fargo Securities LLC
Q

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Got it. Thank you.

Operator: And we'll go next to Tracy Young with Evercore.

Tracy Young
Evercore Partners (Securities)

Q

Hi. I have a question just in terms of the FX for international, how much of that might have affected OIBDA. And then in terms of your guidance, again, how much have you – how much visibility do you feel like you have when you give the guidance? And, Jeremy, you have been in the business for a while. Has visibility changed in the industry? Thanks.

Jeremy John Male
Chairman & Chief Executive Officer

A

Okay. I'll take the second part of that question then pass over to Don on the first part. I think it's fair to say that right the way across the media landscape, that the ad market has become shorter term. Unless there is a requirement to lay down advertising dollars early, then in a way, why would advertisers make those commitments? So, I'd say that the general, and this is very much a worldwide comment that actually outdoor dollars come in later than they did if you look back sort of four years or five years.

As we make our comments now, we're well sold for the fourth quarter. We would have 90% of revenues already laid down at this point for the quarter. But obviously, there's still a way to go and it's – that's why at this stage, I'll certainly just make the comment that any expectation is at this point in time.

Donald R. Shassian
Chief Financial Officer & Executive Vice President

A

And your comment about international impact on OIBDA, it's about $2 million.

Tracy Young
Evercore Partners (Securities)

Q

Okay. Thank you.

Operator: [Operator Instructions] We'll go next to Davis Hebert at Wells Fargo Securities.

Davis s Hebert
Wells Fargo Securities LLC

Q

Good afternoon, everyone. Thanks for taking the questions. When you provided your updated guidance in last – or I think it was September on the flat year-over-year revenue trends, you also mentioned that Van Wagner was pacing positive for the second half. Just curious if that has changed for the acquired Van Wagner assets.

Jeremy John Male
Chairman & Chief Executive Officer

A

No. I mean, obviously, the comment there, Davis, was – for the second half, rather than making any comments for any particular quarter and we haven't seen any particular change for Q4 than we saw in September 10.

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Davis s Hebert
Wells Fargo Securities LLC

Q

Okay. And it's been a month since you've closed that acquisition; just wonder if you could give us an update on your integration activities since that point.

Jeremy John Male
Chairman & Chief Executive Officer

A

Well, as you can imagine, we've been sort of working hard at it. Business came on over to us on – you're right, right at the beginning of October. There have been some of the sort of usual little niggles of systems and software, et cetera. But overall, I think it's fair to say that we're very pleased with the integration. We're very pleased with the comments we're getting back from the marketplace. And we just feel great about it to be honest.

Donald R. Shassian
Chief Financial Officer & Executive Vice President

A

And then, just to add to that, all the systems integration is done. As you know, the closing of the transaction was moved up a little bit early than we originally anticipated. All of our people jumped through hoops to get a lot of activities done so we could be operating out of the gate. And a little bit of things to clean up, the first month. But it is complete. The integration is completed from a systems standpoint and we're trying to get all the processes running really smooth and really go-to-market real hard. So it's done and it's now off to the races and do the best things for our clients.

Davis s Hebert
Wells Fargo Securities LLC

Q

Okay. That's helpful. [audio gap] (29:07 – 29:16) your static portfolio at all?

Jeremy John Male
Chairman & Chief Executive Officer

A

Well, we've said right the way along that our sort of rollout would be – at digital would be measured. That's the term we've used and we've consistently said that we believe that we can build out 100-ish boards per year smartly in areas where we believe that we can minimize any attrition on our static boards. So, when we're looking at making that digital investment, we will estimate revenues for the digital board. We will also take into account, dependent upon the individual circumstances and location of that board, any attrition, assuming we're then making the right returns and we're looking to make returns IRRs of around about sort of 20% on this new investment, assuming that in total, we can make those IRRs, that's when we'll put the new board in.

Donald R. Shassian
Chief Financial Officer & Executive Vice President

A

And if I may add to that, when we look at same board static yields Q3 of 2014 or Q3 of 2013, it essentially was flat. It was up a little bit in second quarter, but essentially was flat in Q3. So we're really not seeing that. We're trying to be very judicious about our selection of where to do it. So, I think we're managing that quite well as maybe compared to what's happening with some other operators.

Davis s Hebert
Wells Fargo Securities LLC

Q

Okay. Very helpful, thank you. And last question for me, Don, did you give any sort of estimate what the top-up dividends may look like? And then a follow-up to that would be – any sort of targets for debt reduction in 2015?

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Donald R. Shassian
Chief Financial Officer & Executive Vice President

A

David, we have not given any guidance on that. I really would like to get through this first year and the tax return calculations and to be able to – and once we have the year completed, we'll announce that. Hopefully, with running the business a little bit more and getting a little bit more comfortable with the process, maybe we'll give a little more guidance ahead of time. But right now, we're not – I do believe a number of the equity analysts have models out there and they've got estimates what the top-up is.

We do expect there will be a top-up, but I think I'd like to finish out the year how strong Q4 is and then really go through the tax return mechanics enough to really come up with that firm number. Target on debt reduction, we have not. I wanted – again, let me go through the year. I think we will be able to get perspectives on that when we talk about year-end numbers and give a better perspective going forward for 2015.

Davis s Hebert
Wells Fargo Securities LLC

Q

Great. Thank you very much for the time.

Operator: And at this time, we have no further questions in the question queue. So, I'd like to turn the call back over to management for any additional or closing remarks.

Jeremy John Male
Chairman & Chief Executive Officer

Well, just to say, thank you, operator, and thank you all for your attendance on this call and for the questions today. We look forward to seeing many of you over the coming weeks in December. We have two investor conferences in New York. So, I look forward to seeing you then. And thanks very much again to all.

Operator: This does conclude today's conference. Thank you for your participation.

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