

FINAL TRANSCRIPT

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GSIT - Q3 2011 GSI TECHNOLOGY INC Earnings Conference Call

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CORPORATE PARTICIPANTS

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GSI Technology, Inc. - Chairman, President and CEO

Douglas Schirle

GSI Technology, Inc. - CFO

Didier Lasserre

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CONFERENCE CALL PARTICIPANTS

Tristan Gerra

Robert W. Baird & Company, Inc. - Analyst

Mike Crawford

B. Riley & Co. - Analyst

Rajvindra Gill

Needham & Company - Analyst

Ted Moreau

WJB Capital - Analyst

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by. Welcome to GSI Technology's Fiscal 2011 Third Quarter Conference Call. At this time, all participants are in a listen-only mode. Later, we will conduct a question and answer session. At that time, we will provide instructions for those interested in entering the queue for the Q&A

Before we begin today's call, the Company has requested that I read the following Safe Harbor statement. The matters discussed in this conference call may include forward-looking statements regarding future events and the future performance of GSI Technology that involves risks and uncertainties that could cause actual results to differ materially. These risks and uncertainties are described in the Company's Form 10-K, filed with the Securities and Exchange Commission.

Additionally, I have also been asked to advise you that this conference is being recorded today, January 27, 2011, at the request of GSI Technology.

Hosting the call today is Lee-Lean Shu, the Company's Chairman, President and Chief Executive Officer. With him are Douglas Schirle, Chief Financial Officer, and Didier Lasserre, Vice President of Sales.

I would now like to turn the conference over to Mr. Shu. Please go ahead, sir.

Lee-Lean Shu - *GSI Technology, Inc. - Chairman, President and CEO*

Thank you. Good afternoon, everyone, and thank you for joining us. In this afternoon's press release, we reported another quarter of solid profitability, with both gross margin and operating margin either within or above our target range.

Year-over-year, third quarter net revenues increased by 50% to \$26.2 million, from \$17.4 million, and the net income almost tripled to \$5.8 million, from \$2.0 million a year ago. Year-to-date numbers are also impressive, at \$75.9 million and \$15.5 million,



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respectively. Net revenues and net income for the first nine months of fiscal 2011 were up by 64% and [the one 35%], respectively, over the comparable period a year ago.

In fact, fiscal 2011 nine-month results already exceed top and bottom-line results for all of fiscal 2010. Moreover, with our expectation, as we noted in today's release, that fourth-quarter revenues will be in the range of \$23.5 million to \$24.5 million. It is apparent that we expect net revenues in fiscal 2011 to approximately \$100 million.

We are pleased at prospect of reaching such a milestone. Far more important, however, is the fact that this growth has not come at the expense of profitability. Complementing the recent growth in revenues are gross margins in the mid-40s and operating margins in the mid-20s. These margins are, we believe, sustainable absent a significant drop in demand for the Company's product which we do not anticipate.

Our success today provides, we believe, a good window on the Company's future. It's a future we view with a considerable optimism. Like those before it, the quarter just ended, and the fact that we have been consistently profitable for the past seven years is a testament to a business model that has enabled us to develop a wide array of product by optimizing R&D expense, fixed costs, and capital expenditures, tightly controlling inventories, and reducing lead time.

Especially important -- we have become a leader in new-product development, with one of the strongest R&D teams in the industry. Their efforts have enabled us to build a loyal and growing stable of customers in the marketplace still dominated by much bigger players. But we have made considerable progress. We estimate that our share of the overall asset market has almost doubled in the last three years, from approximately 6% in fiscal 2008, to approximately 11% today.

We understand that investors, like the Company's customers, look to its past as a measure of its ability to perform in the future. We understand as well that argument -- gauge of management's credibility is the values that investors put on the Company as a whole.

With that in mind, we are pleased to know that the market capitalization of GSI has increased by roughly a third since we spoke with you in late October. This suggests that we are increasingly getting the attention of investors who see the merits of our business model and with it the considerable long-term potential of GSI.

Central to our past performance and to our continuing success is our longstanding commitment to R&D. Most of you who follow GSI know that we take a long-term view of our business. And we have a number of new products in the pipeline that promise to drive revenue for years to come. Among them are second and third-generation [assets], (inaudible), the 144-megabit Type-II series and 72-megabit Type-III series. Each involves SigmaQuad and SigmaDDR configurations.

Also in development is a 576-megabit LLDRAM, designed to serve as a second source for users of Micron popular RLDRAM. Current indications are that LLDRAMs alone could contribute as much of \$10 million in quarterly net revenue in fiscal 2013.

In the meantime, first generation SigmaQuad products will continue to be the growth driver for the Company. Since they first became shipping in volume in fiscal 2008, they now typically account for more than 30% of our growing stream of revenues.

More recently, we have also benefited from sales of the SigmaRAM and the CSRAM product lines purchased from Sony in August 2009, and they add \$4.0 million to third-quarter net revenue, and have contributed just over \$15 million in net revenues since the acquisition.

I will now turn the call over to Doug.



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Douglas Schirle - GSI Technology, Inc. - CFO

Thank you, Lee-Lean. The December quarter was our 29th consecutive quarter of profitability, with record net income of \$5.8 million, or \$0.20 per diluted share. Our net revenues were \$26.2 million.

In the three months ended December 31, 2009, we were at \$2.0 million, or \$0.07 per diluted share; our net revenues were \$17.4 million. Sequentially, net revenues declined by \$503,000, or 1.9%, from \$26.7 million in the second quarter.

Third quarter net revenues were somewhat higher than we had forecast last October, due to higher-than-expected levels of shipments to our largest customer's contract manufacturers during the third quarter, some of which were a result of contractually required consignment hub pool by the customer's contract manufacturers, indicating draw-downs from consignment inventory in advance of the customer's actual manufacturing requirements.

The slowdown in business for this customer that we had expected in our third quarter now appears to have been pushed up to our fourth quarter. And this anticipated slowdown is expected to result in a sequential decline in fourth-quarter revenues.

We currently expect net revenues in the fourth quarter of fiscal 2011 to be in the range of \$23.5 million to \$24.5 million, with gross margin of approximately 45%. For the nine months ended December 31, 2010, net income was \$15.5 million, or \$0.53 per diluted share, on net revenues of \$75.9 million, compared to net income of \$6.6 million, or \$0.24 per diluted share, or net revenues of \$46.3 million in the first nine months of fiscal 2010.

Product lines acquired in the Sony acquisition, completed in August 2009, contributed approximately \$4 million to third-quarter net revenues, compared to \$3.5 million in the second quarter, and have now contributed a total of approximately \$16.1 million.

Third-quarter direct and indirect sales to Cisco Systems were \$9.8 million, or 37.2% of net revenues, compared to \$10.4 million, or 39.1% of net revenues, in the second quarter, and \$6.7 million, or 38.4% of net revenues in the third quarter of fiscal 2010.

Sales to Huawei Technologies were \$2.8 million, or 10.7% of net revenues, compared to \$2.7 million, or 10.1% of net revenues in the second quarter, and \$1.6 million, or 9.3% of net revenues in the third quarter of fiscal 2010.

Military-defense sales were 8.8% of shipments, compared to 7.7% of shipments in the second quarter, and 11.2% of shipments in the third quarter of fiscal 2010. Total third-quarter pre-tax stock-based-compensation expense was \$428,000, compared to \$430,000 in the second quarter and \$411,000 in the comparable quarter a year ago.

Operating expenses are expected to be approximately \$5.3 million in the fourth quarter. We currently expect our effective tax rate to be approximately 20% in fiscal 2011. Net accounts receivable have decreased to \$11.8 million, down from \$15.1 million at September 30th. DSO is 41 days, compared to 52 days in the prior quarter.

Accounts payable at December 31st is \$7.4 million, down from \$10.5 million at September 30th, due to decreased wait for purchases and manufacturing expenses. Net inventory was \$22.5 million at December 31st, down from \$23.2 million at September 30th.

Inventory turns are unchanged from September 30th to December 31st at 2.5 times. At December 31st, our balance sheet remained exceptionally strong, with \$50 million in cash, cash equivalents, and short-term investments; \$28.4 million in long-term investments; almost \$76 million in working capital; no debt; and stockholders' equity of \$118 million.

Operator, at this point, we will open the call to Q&A.



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QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

And your first question comes from Tristan Gerra, with Robert Baird.

Tristan Gerra - *Robert W. Baird & Company, Inc. - Analyst*

Hi. Good afternoon. Could you give us some sense of the sustainability of gross margin, which, obviously, are tracking very strongly, and then pricing trends that you expect for this year -- for this calendar year, as well as any meaningful change you would expect in wafer pricing?

Douglas Schirle - *GSI Technology, Inc. - CFO*

Well, I'll talk to the gross-margin trend. Right now, with the products we have on hand and new products coming out, and work we're doing around cost reductions and so on, we believe that, at least for the next few quarters, we should be able to maintain somewhere in the 45% gross-margin range.

Didier Lasserre - *GSI Technology, Inc. - VP of Sales*

Tristan, it's Didier. As far as pricing, except for a couple of isolate anomalies, pricing is pretty much trending the way we expected, which is the highest-density, newest parts coming down, and the lower-density devices stabilize. So, there's really nothing changing at this point on the horizon for pricing.

Tristan Gerra - *Robert W. Baird & Company, Inc. - Analyst*

Okay. And with the pricing -- no expectations of any increases near term?

Lee-Lean Shu - *GSI Technology, Inc. - Chairman, President and CEO*

I would say stable -- actually, (inaudible) compared to last quarter.

Tristan Gerra - *Robert W. Baird & Company, Inc. - Analyst*

Okay. And then, could you elaborate a little bit on your large customer that basically is seeing weakness pushed out by one quarter? And if you could also comment on the amount of products that you have at the hubs still exceeding the 90-day threshold.

Douglas Schirle - *GSI Technology, Inc. - CFO*

Right. So, as you mentioned, we were expecting this aged inventory that was contractually taken in September -- we expected that December would be a weak quarter for our space off of that. Ends up there was actually more of that aged material that was taken in December, which basically pushed out one quarter -- the weakness we're going to see.

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As far as making sure that doesn't happen again -- the aged material, you have to understand, was in there for over 90 days, and so this was material that was put in the hub back in late summer. Since then, this particular customer, obviously, has adjusted for those over-inventories.

And so, what we're seeing now in those consignment warehouses is more normalized inventory, based off of some of the material they have to take contractually, and also on their new run rates.

So I don't see any level of that happening in this March quarter. I certainly think there will be a little bit, but it'll be much, much less than we saw in the September and the December quarter.

Tristan Gerra - *Robert W. Baird & Company, Inc. - Analyst*

So, it sounds like the -- you're seeing kind of the tail end of that inventory increase, then.

Douglas Schirle - *GSI Technology, Inc. - CFO*

Absolutely, yes. At this point, in the hub, absolutely. Certainly, as far as the customer -- they're going to have to still work through some of the material that they have on-hand. But as far as in the hub -- the hubs look pretty clean right now.

Tristan Gerra - *Robert W. Baird & Company, Inc. - Analyst*

Okay. And, then, finally, could you give us, maybe, some color on the demand outlook by geographies? You mentioned the percentage of revenues from Huawei, do you expect that to be stable in the coming quarter -- and, also, whether you see, in Europe -- or anything else you can bring color on by geography.

Douglas Schirle - *GSI Technology, Inc. - CFO*

By geography -- so, by geography, we actually -- Europe was very weak for us in this past December quarter. If I looked at the -- we were joking internally, if we look at the numbers, it looks like they went on vacation starting the middle of November.

Certainly, we see them coming back a little bit -- the signs are coming back. But, certainly, Europe was a weakness for us in the December quarter. As far as this quarter, I -- again, I see Europe recovering a little bit. And the other markets, I think, are stable.

Tristan Gerra - *Robert W. Baird & Company, Inc. - Analyst*

Great. Thank you.

Douglas Schirle - *GSI Technology, Inc. - CFO*

You're welcome.

Operator

Your next question comes from Mike Crawford with B. Riley & Company.

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Mike Crawford - B. Riley & Co. - Analyst

Thanks. Could you please elaborate on where you stand with the LLDRAM product, and how you think that is stacking up with RLDRAM or bandwidth engine?

Didier Lasserre - GSI Technology, Inc. - VP of Sales

So we -- we spoke last time. We had seen silicon, and we were going through a debug process. We have gone through that process and have fixed all the identified bugs, and are actually in fab right now with second silicon.

So we'll be seeing packaged units some time in the March timeframe, which will allow us to identify or at least characterize the part, and see if we have identified all of the bugs. And so, we'll know more in March. But at this point, we're in fab with second silicon.

As far as how it stacks up with RL, we'll certainly -- the LL device is meant to second-source the RL socket. So in that respect, I mean, that's certainly the market we're addressing.

Mike Crawford - B. Riley & Co. - Analyst

Okay, thanks. And in terms of R&D, what are your [mass set] plans for the coming year?

Douglas Schirle - GSI Technology, Inc. - CFO

Yes, right now there's nothing that I could foresee that should hit the R&D lines. Most of the tape-outs and the fab are going to be far enough along, in terms of new products, that we'll probably charge them to cost of goods sold. And there are also other mass sets we'll be seeing throughout the year for product shrinks and cost-reduction purposes. But those all hit cost of goods sold, and that's in our gross-margin forecast.

Mike Crawford - B. Riley & Co. - Analyst

Okay, thank you.

Douglas Schirle - GSI Technology, Inc. - CFO

Thank you.

Operator

(Operator Instructions)

Your next question comes from Rajvindra Gill, with Needham & Company.

Rajvindra Gill - Needham & Company - Analyst

Yes, thanks for taking my questions. A follow-up on the question before me -- your nearest competitor had talked about being the second source on RLDRAM-III to Micron -- leveraging Micron's technology. And I wanted to get your thought process on where you are on the RLDRAM-III type of node. Any color there would be helpful.

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Didier Lasserre - *GSI Technology, Inc. - VP of Sales*

Yes. So, as you mentioned the competitor -- for me, I find it interesting that they're only talking about the RL Type-III. So, I believe that's where the agreement with Micron is -- stops. I don't think it covers any of the RL-II at all. So, what we're talking about right now -- the parts that are in fab are for the RL-II.

So the RL-II -- we're all looking to second-source each other. The RL-III -- there is going to be a fragmentation in the market at this point. So there are two technologies out there right now -- a technology that is, obviously, known, with the Micron RL-III. And then there's another competing technology which was actually defined by Cisco, NEC, and GSI. And it actually -- they don't second-source each other, and they're competing architecture.

Right now, we are looking at this other architecture -- not to say we won't look at RL-III at some point. But, certainly, our first interest is this other technology which would compete technically with RL-III, but would not be pin-for-pin compatible.

Rajvindra Gill - *Needham & Company - Analyst*

So the RLDRAM-II is around the 576-megabyte density. Is that correct, or --?

Didier Lasserre - *GSI Technology, Inc. - VP of Sales*

The two densities are -- in the market space today are 576 and 288. The RL-III, I believe, is targeted for 1 gig or 1.2 gig, which is also this competing technology that we're working on.

Rajvindra Gill - *Needham & Company - Analyst*

Okay. So you talk about the overall opportunity being around 200 million to 300 million TAM. And based on my estimates, it seems like Micron controls about 80% of that. Now, how do you make the distinction between the RLDRAM-II and the RLDRAM-III within that overall TAM that you talked about? And we'll just stop there and then --.

Didier Lasserre - *GSI Technology, Inc. - VP of Sales*

So there is no RL Type-III TAM today. That's going to be future TAM. Certainly, I believe that they're looking to sample that technology -- the first family -- sometime summer or second half of the year, so there is no sales right now. All the sales we're talking about is based off of the 288 and the 576-meg Type-II. So, the RL-III will be continued growth beyond that. You had mentioned this other competitor. They had estimated the market to go to 400 million to 500 million. Certainly, I think they're a bit optimistic. But that would incorporate the next generation -- the RL Type-III and also what we're working on in conjunction with Cisco and NEC.

Rajvindra Gill - *Needham & Company - Analyst*

What do you think the lifecycles are in the RLDRAM-II market? How long do you think the design cycles are?

Didier Lasserre - *GSI Technology, Inc. - VP of Sales*

Very similar to SRAMs -- so there'll be seven years, most likely. I mean, certainly, that's what we're asked to sign up for with our customers. And you have to understand that even though this is a DRAM, the market behavior is that of an SRAM, not of a commodity DRAM.

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So, the companies that we're selling these parts into are the same telecom companies that we're selling our SRAMs into. So their expectation is the same lifecycle as our SRAMs, which is minimal of seven years is what we're signing up for.

Rajvindra Gill - *Needham & Company - Analyst*

So you would commit to the customer that you would be able to supply RLD RAM bits for seven years, where -- and that would be part of your value proposition, relative to, say, Micron, who might stop after three years or four years. (Inaudible) continual supply --

Didier Lasserre - *GSI Technology, Inc. - VP of Sales*

Yes --

Rajvindra Gill - *Needham & Company - Analyst*

At a negotiated type of price.

Didier Lasserre - *GSI Technology, Inc. - VP of Sales*

Right. So, certainly, that is -- when you talk about agreements that we have in place with our largest customers, that seven-year lifecycle is certainly one of the major points in these agreements. And so, certainly, that's their expectation. I certainly can't comment on what Micron's lifecycles are. But certainly, I know that we're signed up for seven years.

And certainly, we're allowed to do some die revisions in there, but they're looking to make sure that we have form, fit and function devices for a minimum of seven years.

Rajvindra Gill - *Needham & Company - Analyst*

Very good. And just last question for me -- in terms of some of the growth drivers by vertical, maybe you -- could you describe in a couple bullet points where you see the demand drivers in kind of military defense, network and telecom and what's kind of driving that for your business?

Didier Lasserre - *GSI Technology, Inc. - VP of Sales*

Yes. So, military -- this quarter, the military was up, as we mentioned. We had a few customers that were up in that segment, a couple whom -- that were flat, and some that were down. And that's just the nature of the military business. It's just very lumpy.

We certainly have a significant program that we're working on that should kick-in in 2012, and will be -- I believe it's a three-year program. So, certainly, they'll be safe for three years. So this particular program, in itself -- if they hit the target quantities they've forecasted to us could put this customer, certainly, top ten for sure and, possibly, top five. So, it's a significant program. And, again, that's -- it won't kick-in until 2012.

As far as the telecom market -- obviously, bandwidth is still the huge driver. And so, we certainly have one customer who is offering a 100-gig sort of provider router. And we have the sole position on the memory requirements for that box. And it will be ramping as 2011 progress.

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Rajvindra Gill - *Needham & Company - Analyst*

Very good. And, congrats, on the results. Thank you.

Didier Lasserre - *GSI Technology, Inc. - VP of Sales*

Thanks.

Operator

Your next question comes from Ted Moreau with WJB Capital.

Ted Moreau - *WJB Capital - Analyst*

I wanted to just maybe leverage off that last question on the demand drivers. Can you determine, in your latest results on the revenue line, and also on your guidance, how much might be just from traditional demand drivers and market conditions and how much might be from any market-share shifts that might be occurring in your traditional product lines?

Didier Lasserre - *GSI Technology, Inc. - VP of Sales*

So I haven't really seen too much market-share shift. Certainly, I would say the SRAM market was flat this last quarter, and our revenues were essentially flat. So I don't see, per say, any market share change at this point.

With that, say, as far as the drivers -- it was an interesting quarter because some of the folks that were doing things like [MOL] backhaul -- a couple of customers doing that were strong, a couple of them were weak.

We have a few customers that are building test equipment for the networking and telecom market space. And our two largest customers in that market space -- one was down about 30%. The other guy was up almost double. And so, it's kind of a scattered bag, unfortunately, right now. I'd like to be able to give you great trends, but right now, it's a bit confusing.

Ted Moreau - *WJB Capital - Analyst*

Do you anticipate, looking out, though, that there will be some market share opportunities for you, and that could be a driver in addition to these traditional or emerging market drivers that you described?

Didier Lasserre - *GSI Technology, Inc. - VP of Sales*

Oh, absolutely. So, as Lee-Lean mentioned earlier, we're the only company right now shipping volume of the 144-megabit device, which -- of the SigmaQuad, which there's rumored a second supplier that had samples that -- customers still aren't getting them. And that market is growing.

Certainly, the SigmaQuad-III, which, right now, for the highest bandwidth requirements out in the market space we're the only solution. I mean, we're -- if you're looking at the transaction rate, we're about 1.2 gig, and our nearest competitor is 800 meg. So, we have a huge advantage over the nearest competitor.

So, certainly, as bandwidth requirements become more critical, that part will become more and more popular. And, in general, we certainly are doing some die revisions on our current product family to help drive the cost model.

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And we've talked about Samsung in the past -- how they have not been doing die revisions. And they're still a significant player in the market. At some point, I think that we're going to gain more market share against them, just based off of price alone.

Ted Moreau - *WJB Capital - Analyst*

But you haven't seen much advantage here from the Samsung position in the market, right -- at the current time? Is that correct?

Didier Lasserre - *GSI Technology, Inc. - VP of Sales*

No, not yet.

Ted Moreau - *WJB Capital - Analyst*

Okay, great. Well, thank you.

Didier Lasserre - *GSI Technology, Inc. - VP of Sales*

Yes, I think that's going to take some time. And that goes back to what we talked about for us in the SRAM market -- it just doesn't come down that fast. And so, they'll hang around for a little while as the price slowly comes down. Again, the SRAM pricing just isn't that volatile.

Ted Moreau - *WJB Capital - Analyst*

Right. Great. Well, thank you. And, congratulations, on the quarter.

Didier Lasserre - *GSI Technology, Inc. - VP of Sales*

Thanks, Ted.

Operator

(Operator Instructions)

And at this time, there are no further questions.

Lee-Lean Shu - *GSI Technology, Inc. - Chairman, President and CEO*

Thank you all for joining us. We look forward to speaking with you in May, when we will report our fourth quarter and year-end fiscal 2011 results. Thank you.

Operator

This concludes today's conference. You may now disconnect.

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