

## — PARTICIPANTS

### Corporate Participants

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**Joe Shiffler** – Director-Investor Relations & Communications  
**Balu Balakrishnan** – President, Chief Executive Officer & Director  
**Sandeep Nayyar** – Chief Financial Officer & Vice President

### Other Participants

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**Evan Y. Wang** – Analyst, Stifel, Nicolaus & Co., Inc.  
**Andrew Huang** – Analyst, Sterne, Agee & Leach, Inc.  
**J. Steven Smigie** – Analyst, Raymond James & Associates  
**Mike Chu** – Analyst, Deutsche Bank Securities, Inc.  
**Chris J. Longiaru** – Analyst, Sidoti & Co. LLC

## — MANAGEMENT DISCUSSION SECTION

Operator: Good day, ladies and gentlemen and thank you for your patience. You've joined the Power Integrations' Q1 2012 Financial Results Conference Call. At this time, all participants are in a listen-only mode. Later we will conduct a question-and-answer session. [Operator Instructions]

As a reminder, this conference is being recorded. I would now like to turn the call over to your host, Mr. Joe Shiffler. Sir, you may begin.

### Joe Shiffler, Director-Investor Relations & Communications

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Thank you. Good afternoon and thanks for joining us to discuss Power Integrations' financial results for the first quarter of 2012. With me on the call are Balu Balakrishnan, President and CEO of Power Integrations and Sandeep Nayyar, our Chief Financial Officer.

During today's call we will refer to financial measures not calculated according to generally accepted accounting principles. Please refer to today's press release available on our website at [investors.powerint.com](http://investors.powerint.com) for an explanation of our reasons for using such non-GAAP measures as well as tables reconciling these measures to our GAAP results.

Also our discussion today, including the Q&A session, will include forward-looking statements, reflecting management's current forecast of certain aspects of the company's future business. Forward-looking statements are denoted by such words as will, would, believe, should, expect, outlook, estimate, plan, goal, anticipate, project, potential, schedule, forecast and similar expressions that look toward future events or performance. Forward-looking statements are based on current information that is by its nature dynamic and subject to rapid and even abrupt changes. Our forward-looking statements are subject to risks and uncertainties, which may cause actual results to differ materially from those projected or implied in our statements. Such risks and uncertainties are discussed in today's press release and under the caption, Item 1A Risk Factors in Part 2 of our most recent Form 10-K filed with the Securities and Exchange Commission on February 29, 2012.

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And now I'll turn the call over to Balu.

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**Balu Balakrishnan, President, Chief Executive Officer & Director**

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Thanks, Joe and good afternoon. We delivered strong first quarter results with revenues exceeding the high end of our projected range and our non-GAAP gross margin expanding by a full percentage point to its highest level since 2010. We also generated more than \$21 million in cash flow from operations and reduced internal inventories to their lowest level in nearly two years.

The strength in our first quarter revenues was driven mainly by the industrial and consumer end markets, both of which grew at double-digit rates, sequentially after declining in the fourth quarter. The strength in the industrial was broad based, with growth in LED lighting, process and motor control applications, UPS and metering applications among others. The growth in consumables, primarily in the appliance market, including seasonal strength in air conditioning, as well as a rebound in white goods after several quarters of softness in that market.

The overall improvement in bookings that began in November has continued through the first quarter and the month of April and we expect significant sequential growth in revenue again in the second quarter. Specifically, we expect second quarter revenues between \$78 million and \$84 million, an increase of 9% to 17% sequentially. This forecast includes two months of revenues from Concept, which we acquired on May 1.

For those who may have missed the announcement last month, Concept was a privately held Swiss company, developing highly integrated drivers for high voltage IGBT modules. We acquired them for approximately \$115 million, net of cash assumed, and we expect them to add roughly 10% to our revenue run rate.

Essentially, Concept does for IGBT drivers what we do for power supplies, replacing discrete solutions with much more sophisticated designs that offer lower component count, higher reliability, data, and energy efficiency. Their products are used in power conversion applications up to 1 gigawatt of output, including industrial motor drives, solar and wind power systems, electric trains and trams, electric cars, and DC transmission among others, a total addressable market approaching \$0.5 billion and growing.

Concept fits perfectly into our stated strategy of expanding our available market to cover a wide range of applications within our core competency of high voltage power conversion. Our hyper product family along with the complementary CAPZero, SENZero and Qspeed product lines have added \$0.5 billion to our addressable market opportunity, and now with the acquisition of Concept, we are expanding beyond the demand side of the power ecosystem into the generation and transmission areas as well, where factors like efficiency and reliability are arguably even more important.

Concept is also highly complementary to our investment in SemiSouth Laboratories, since Concept technology and know how can be used in conjunction with SemiSouth silicon carbide transistors, which are beginning to replace silicon IGBTs, thanks to their durability and high level of energy efficiency. This combination would give us a complete offering of drivers and high voltage switches for very high power applications, much like what we have today for power supply applications up to 500 watts and could expand our total addressable market to well over \$5 billion.

Returning to our first quarter results, I'd like to highlight our gross margin, where we are making good progress in our effort to reverse the recent declines stemming from external factors like the dollar to yen exchange rate and the price of gold.

Our first quarter non-GAAP gross margin was 48.8%, an increase of 100 basis points from the prior quarter, driven partially by end market mix but also reflecting continued execution on the cost reduction efforts we have discussed on past conference calls. This is our highest non-GAAP gross margin since 2010 despite the fact that the dollar remains depressed against the yen and that gold prices remain elevated.

As noted in our press release, we expect roughly another 100 basis points of improvement in the second quarter as our costs reductions gain further traction, as we see the benefit of higher production volumes plus a slight benefit from the addition of Concept. While margin trends beyond Q2 are not entirely predictable, we believe we are on track to achieve our goal of returning to the 50% level on a non-GAAP basis by the end of this year.

Lastly, I'd like to highlight the favorable verdict we received last week in our patent infringement case against Fairchild Semiconductor. After a three-week trial, the jury found that Fairchild infringes two Power Integrations' patents, a decision implicating approximately 75 Fairchild products. We will ask the court for an injunction preventing the sale of these products in the U.S. and more importantly use of these products in the end products destined for the U.S. market. That would add to the list of more than 100 Fairchild products already subject to permanent injunction, based on previous findings in the infringement.

We also intend to pursue financial damages as well as finding of willful infringement which could result in enhancement of any damage award. The jury in this case did rule against us on one of the two counterclaims filed by Fairchild, an outcome we intend to challenge on several different grounds. However, unlike the findings against Fairchild, the jury ruled that we did not induce infringement by any of our customers. Therefore, even if the verdict was ultimately upheld, the only sales potentially impacted could be U.S. sales of accused products which amount to only about one tenth of one percent of our total worldwide revenues.

We believe this outcome overall is a highly favorable to Power Integrations and we hope it will help put a stop to Fairchild's persistent violation of our patent rights which has been ongoing for better part of a decade and has now resulted in three separate findings of infringement by Fairchild and its System General subsidiary. With that, I'll turn the call over to Sandeep for a review of the financials.

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**Sandeep Nayar, Chief Financial Officer & Vice President**

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Thanks, Balu, and good afternoon. I will briefly review the details of the first quarter results and the second quarter outlook and then we will move to the Q&A. Revenues for the first quarter were \$71.8 million, up 8% sequentially and above our projected range of \$64 million to \$70 million. As Balu explained, the growth was driven mainly by industrial and consumer end markets, each of which grew at a low double digit rate sequentially. Revenues from communication end market grew mid single digit sequentially while revenues from the computer market were down slightly from the prior quarter.

Distributors accounted for 71% of sales during the quarter, while direct customers made up 29%. Average selling price for the quarter was \$0.28, unchanged from the prior two quarters. GAAP and non-GAAP gross margin increased from the prior quarter by 90 and 100 basis points respectively, reflecting continued progress on our cost reduction efforts, more favorable end market mix and the higher than expected revenues, which resulted in more flow through of cost reduced inventory.

Non-GAAP operating expenses were \$22.6 million, up \$1.1 million from the prior quarter and in the middle of our projected range. As expected, the increase was driven by the resumption of the payroll taxes as well as the one-time nature of certain expense reductions we took in the fourth quarter of 2011 such as the holiday shutdown. GAAP operating expenses were \$25.9 million, up

about \$2 million sequentially and towards the high end of the projected range due to expenses related to Concept acquisition, which totaled about \$0.5 million.

Non-GAAP earnings were \$0.36 per diluted share, up \$0.07 from the prior quarter. GAAP net income was \$0.25 per diluted share. Cash flow from operations was \$21.6 million for the quarter, while capital expenditures totaled \$7.5 million. The other significant use of cash during the quarter was a loan of \$18 million to SemiSouth to help fund their continued growth. The loan appears in the other assets category on the balance sheet. All in, cash and investments increased by just over \$1 million from the prior quarter, totaling \$214 million at quarter end. Obviously our cash balance will come down in the second quarter as a result of the Concept acquisition, which resulted in a net use of approximately \$116 million in cash.

Returning to the balance sheet, internal inventories were \$43 million at quarter end, down about \$9 million from the prior quarter. Days of inventory on hand fell to 105 days, a decrease of 30 days from the prior quarter. This is the lowest level of internal inventory in nearly two years, both in terms of dollars and days.

Deferred income and shipments to distributors picked up by about \$1.5 million from the prior quarter, reflecting a slight increase in channel inventories, which grew to 4.8 weeks, after reaching multi-year lows last quarter.

Turning to the outlook, we expect revenues to be between \$78 million and \$84 million in the second quarter, including two months of Concept results. Since we expect Concept to add roughly 10% to our ongoing revenue run rate, it would be reasonable to back out 6 percentage points to 7 percentage points of growth from our Q2 forecast for purpose of calculating sequential growth, excluding Concept.

We expect non-GAAP gross margin to expand by roughly another 100 basis points in the second quarter relative to the first quarter. GAAP gross margin will be lower on a sequential basis, due mainly to amortization charges related to the markup of the acquired Concept inventory, which should be about \$1.5 million for the quarter. Non-GAAP operating expenses should be in the range of \$24 million to \$25 million, an increase of about \$2 million sequentially at the midpoint, driven by the Concept acquisition. GAAP operating expenses should be \$29 million plus or minus \$0.5 million, reflecting \$3.5 million of stock-based compensation plus acquisition expenses and amortization of intangibles, which should total about \$0.5 million each.

Lastly, I expect the second quarter tax rate to be between 21% and 22% on a GAAP basis and 18% to 19% on a non-GAAP basis. With that, I'll turn it back over to Joe.

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**Joe Shiffler, Director-Investor Relations & Communications**

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Thanks, Sandeep. We'll go ahead and open it up for Q&A now. In the interest of time, I'd like to ask callers to observe a limit of one question and one follow-up, and then we'd be happy to come around for a second round of questions after that, time permitting. Operator, would you please give the instructions for the Q&A session.

**QUESTION AND ANSWER SECTION**

Operator: My pleasure, sir. [Operator Instructions] Our first question comes from Tore Svanberg of Stifel, Nicolaus. Your line is open.

**<Q – Evan Wang – Stifel, Nicolaus & Co., Inc.>**: Hi. This is Evan Wang. Thank you for taking the question. I'm calling in for Tore. Could you break down the CT-Concept impact on all your financials in the coming quarter? In terms of OpEx for example, how much would they be contributing to your R&D versus SG&A?

**<A – Balu Balakrishnan – Power Integrations, Inc.>**: As we had indicated in our previous call, basically Concept will account for about 10% of our revenue, and the expenses as a percentage of revenue will be slightly below the percentage that we incur as a percentage of our revenue prior to the acquisition.

**<Q – Evan Wang – Stifel, Nicolaus & Co., Inc.>**: And the breakdown between R&D and SG&A is roughly the same as yours?

**<A – Balu Balakrishnan – Power Integrations, Inc.>**: It's roughly the same percentage, roughly, but it's approximate.

**<Q – Evan Wang – Stifel, Nicolaus & Co., Inc.>**: I see. Could you also talk a little bit about your industrial was up significantly, I assume that LED is one of the main drivers there?

**<A – Balu Balakrishnan – Power Integrations, Inc.>**: LED is definitely one of the main drivers, but we also had a very broad improvement across the entire industrial applications, such as UPS, power supplies, meters, motor control, process control, so a very broad based increase in industrial.

**<Q – Evan Wang – Stifel, Nicolaus & Co., Inc.>**: Great. Thank you very much.

**<A – Balu Balakrishnan – Power Integrations, Inc.>**: You're welcome.

Operator: Thank you. Our next question comes from Andrew Huang of Sterne, Agee. Your line is open.

**<Q – Andrew Huang – Sterne, Agee & Leach, Inc.>**: Just a quick question on CT-Concept again. Since you're only going to get two months of contribution for the June quarter, I guess my first question is should we assume that there's going to be further improvement to margins in the September quarter, all else being equal, because you're going to get a full contribution? And then the follow-up would be down the road are there additional synergies that maybe we haven't seen yet?

**<A – Sandeep Nayyar – Power Integrations, Inc.>**: So, as you know, it's 10% of our – Concept is 10% of our revenue. So, it does benefit incrementally to our margin, but it's a small percentage. But considering you're having a full quarter, you're correct. It'll be slightly more better for the full quarter.

**<A – Balu Balakrishnan – Power Integrations, Inc.>**: Yeah. Just to add a little bit more color, we explained in the last conference call about the CT acquisition, that they're on the high-end of our model, our 50% to 55% gross margin model, they're on the higher end of it. Therefore, you can compute from the roughly 10% revenue related to ours, what the impact would be? And it'll obviously be small compared to the total improvement we are seeing in gross margin.

<Q – Andrew Huang – Sterne, Agee & Leach, Inc.>: Okay. And if you don't mind me asking, the \$18 million loan to SemiSouth, can you give us a little color on – specifically what that's for?

<A – Sandeep Nayyar – Power Integrations, Inc.>: It's basically to fuel their growth in terms of capital equipment and working capital. They are getting traction with their product, and they need to expand their capacity, and they also need working capital.

<Q – Andrew Huang – Sterne, Agee & Leach, Inc.>: Thank you.

<A – Sandeep Nayyar – Power Integrations, Inc.>: You're welcome.

Operator: Thank you. Our next question comes from Steven Smigie of Raymond James. Your line is open.

<Q – J. Steven Smigie – Raymond James & Associates>: Thanks a lot. I'm not sure if I heard you right, but did you say that you're hoping to get to 50% gross margin by the end of the year? And if that's the case, is there some chance you can get above that 50%?

<A – Sandeep Nayyar – Power Integrations, Inc.>: It's hard to predict, as I already said, sorry. But our expectation as we have said all along in the fourth quarter is that we will get to the 50% level.

<Q – J. Steven Smigie – Raymond James & Associates>: Okay. But I mean, seems like you should be able to get above that pretty easily – I mean, you seem pretty close right now already.

<A – Sandeep Nayyar – Power Integrations, Inc.>: Yeah. It's possible to be slightly above that, but at this point, because there are – it's hard to predict everything that happens, so we've been making steady improvements, and we are pretty much on target to hit that mark.

<A – Balu Balakrishnan – Power Integrations, Inc.>: Again, to add more color to that, we have seen pretty much all of the – we would have seen pretty much all of the cost improvements that we set out with last year in Q2. We will get incremental improvements in Q3 and Q4, primarily related to the copper conversion from gold. That is going to be gradual, so you'll see some improvement. So, the large part of the improvement would have occurred by the end of Q2.

<Q – J. Steven Smigie – Raymond James & Associates>: Okay. And then, my other question was just, I know September is a long way out, and you guys typically – you go through distribution and don't have great visibility, is September for you has traditionally been a pretty strong seasonal quarter. I think you've been diversifying away from that communications or handset business, whatever you want to call it. So, is it fair to think you'd be up, have a pretty nice potential seasonal growth, but maybe not the double-digit as you've had in the past? And if I could just sneak in a housekeeping item, the tax rate was up here a little bit. What should we be thinking about through the balance of this year and maybe into next year? Thanks.

<A – Balu Balakrishnan – Power Integrations, Inc.>: Let me answer your first question, and then Sandeep can answer the second. It's – we do have an average seasonality, but every year it seems to be different. It's very, very hard to predict what's going to happen. So yes, you're right, Q3 is usually a growth quarter for us, although if you look at the last few years, Q2 and Q3 both have been growth quarters, somewhat of equal magnitude. So – and that's not a prediction by any means, I'm just telling you what historically we have seen. So internally, we are modeling some growth in Q3, and once again, that's not a prediction. That's just an internal modeling that we do for the September quarter. And maybe you can answer the...

<A – Sandeep Nayyar – Power Integrations, Inc.>: Yeah. For the tax rate, it can vary based on the geographic distribution of [indiscernible] (21:23). And that's why we gave you – so the

approximate numbers, the 18% plus or minus, and that's why we gave you a range for the second quarter, but non-GAAP 18% plus or minus is a good one. And for the GAAP, it's somewhere around 21% plus or minus.

**<Q – J. Steven Smigie – Raymond James & Associates>**: Okay. Great. Thank you.

Operator: Thank you. Our next question comes from Ross Seymore of Deutsche Bank. Your line is open.

**<Q – Mike Chu – Deutsche Bank Securities, Inc.>**: Hi. This is Mike Chu for Ross. Congratulations, guys, on a good quarter and guide. Just a question on maybe if you can provide some color on where you see relative strength on some of your end markets, and foreign markets? And maybe if you could speak specifically to whether or not you think the industrial and consumer strength that you saw in the first quarter will continue on into the second quarter?

**<A – Balu Balakrishnan – Power Integrations, Inc.>**: So, let me make a few comments on that. Industrial historically has been seasonally strong in Q1. Part of the reason is the industrial, if you look at even other companies like Linear and so on, they always see industrial being strong in Q1. And the consumer side, the strength was primarily in appliances, and that was to some extent driven by air conditioners, which are normally built in Q1 for summer. So Q1 is the peak for air conditioners.

But we also saw the rest of the white goods coming back very strongly after several quarters of weakness. So, it looks like finally they are flushed through the inventory and they are buying products. So, those are the two big ones. And communications was up in the mid single-digits, whereas industrial and consumer were up in the double-digits, and computer was flat.

**<Q – Mike Chu – Deutsche Bank Securities, Inc.>**: Okay. Thanks. And maybe just as a follow-up, if you could talk about some of the underlying trends and the comps, it was up four. Typically, it's a seasonally weaker quarter. How do you expect the communications segment to kind of play out through the rest of the year?

**<A – Balu Balakrishnan – Power Integrations, Inc.>**: I'm not quite sure. It's a very – it's somewhat dominated by cell phone market, which is quite volatile in terms of who get shares every quarter. I am somewhat optimistic that we will grow that segment based on many of the design activities that's going on.

**<Q – Mike Chu – Deutsche Bank Securities, Inc.>**: That's helpful. Thank you.

**<A – Balu Balakrishnan – Power Integrations, Inc.>**: You're welcome.

Operator: Thank you. Our next question comes from Christopher Longiaru of Sidoti & Company. Your line is open.

**<Q – Chris Longiaru – Sidoti & Co. LLC>**: Hey, guys. Congratulations on the results.

**<A – Sandeep Nayyar – Power Integrations, Inc.>**: Thank you.

**<A – Balu Balakrishnan – Power Integrations, Inc.>**: Thanks, Christopher.

**<Q – Chris Longiaru – Sidoti & Co. LLC>**: So, first thing, I just wanted to check and see where channel inventory is in your estimation now. I think the last call you said it was at the lowest level you'd seen since 2008, but I wanted to know if there's any relative commentary there?

**<A – Balu Balakrishnan – Power Integrations, Inc.>**: Our lead times are between four and six weeks and in the last call when we had seen it go down and we had expected it to nudge up and it exactly did. So, we're expecting it to be between around five weeks, give and take, because of our lead times being the four to six weeks.

**<Q – Chris Longiaru – Sidoti & Co. LLC>**: Okay. And that's because pushing that low end is just too – it's not enough time to get product, is that how I understand it?

**<A – Balu Balakrishnan – Power Integrations, Inc.>**: Well, you have to remember that 70% of our business goes through distribution, and the distributors, if they don't have approximately five weeks of inventory, they can't service their customers with a four to six week lead time.

**<Q – Chris Longiaru – Sidoti & Co. LLC>**: Right. Okay. The only other thing was could you give us kind of just an update on your idea for how the LED business is going to progress over the next 12 months?

**<A – Balu Balakrishnan – Power Integrations, Inc.>**: Well, it's hard to predict except that we continue to have strong design wins. So, I think we projected earlier that – not projected, we said earlier that we could grow 50% this year relative to last year.

**<Q – Chris Longiaru – Sidoti & Co. LLC>**: Thank you.

**<A – Balu Balakrishnan – Power Integrations, Inc.>**: You're welcome.

Operator: Thank you. We have a follow-up question from Andrew Huang of Sterne Agee. Your line is open.

**<Q – Andrew Huang – Sterne, Agee & Leach, Inc.>**: Thanks. I just wanted to ask a follow-on on the LED lighting. Can you give us a sense of what percentage of your lighting business is for light bulbs versus the fixtures?

**<A – Balu Balakrishnan – Power Integrations, Inc.>**: That's a great question and I've asked this question many times. We have a hard time nailing that down because when we sell the product to the LED customers, sometimes we had actually involved the design of the board, PC board, but we never know exactly what form factor it goes into. But if I look at across the board, it's really a mixture, probably a good mixture I would say of individual lamps and also fixtures for commercial applications and some street lighting.

**<Q – Andrew Huang – Sterne, Agee & Leach, Inc.>**: Okay. And then I guess another question along those lines. I guess, when you're competing for business for your drivers for LED lighting, what do you think gets you the win more often than not? Is it your features or is it your price? Like, what makes you win?

**<A – Balu Balakrishnan – Power Integrations, Inc.>**: I think the main thing is cost. We have a very low cost solution with a single-stage approach and we have the lowest component count of anybody. And the third one, actually there are really three reasons. And the third one is, we have the highest efficiency solution. Those are the three reasons people would pick us.

**<Q – Andrew Huang – Sterne, Agee & Leach, Inc.>**: Got it. Thanks very much.

**<A – Balu Balakrishnan – Power Integrations, Inc.>**: You're welcome, Andrew.

Operator: Thank you. [Operator Instructions] And gentlemen, there appear to be no further questions in queue at this time. Are there any closing remarks?



**Joe Shiffler, Director-Investor Relations & Communications**

No, thank you. We'll leave it there. There will be a replay of this call available on our website at [investors.powerint.com](http://investors.powerint.com). And thanks, everyone, for listening.

Operator: Thank you, sir, and thank you, ladies and gentlemen for your participation. That does conclude your Power Integrations' Q1 2012 financial results conference call. You may disconnect your lines at this time. Have a great day.

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