

— PARTICIPANTS

Corporate Participants

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

Other Participants

Vernon P. Essi – Analyst, Needham & Co. LLC
Ross C. Seymore – Analyst, Deutsche Bank Securities, Inc.
Andrew Huang – Analyst, Sterne, Agee & Leach, Inc.
Sumit Dhanda – Analyst, International Strategy & Investment Group, Inc.
J. Steven Smigie – Analyst, Raymond James & Associates

— MANAGEMENT DISCUSSION SECTION

Operator: Good day, ladies and gentlemen and thank you for your patience. You've joined the Power Integrations Q3 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, and instructions will be given at that time. [Operator Instructions] As a reminder, this conference may be recorded.

I would now like to turn the call over to your host, the Director of Investor Relations, Mr. Joe Shiffler. Sir, you may begin.

Joe Shiffler, Director-Investor Relations & Communications

Thank you. Good afternoon, and thanks for joining us to discuss Power Integrations' financial results for the third 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, 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," "promising," "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-Q filed with the SEC on August 7, 2012.

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

Balu Balakrishnan, President, Chief Executive Officer & Director

Thanks, Joe, and good afternoon. Our third quarter operating results were solid in light of the current business climate with revenues of \$78 million, just below the midpoint of our projected range, and non-GAAP earnings of \$0.49 per share, up more than 50% from a year ago. The primary driver of that growth was our gross margin, which increased for the fourth consecutive quarter and is up nearly 6 percentage points over the past year.

Before I go further into the results, I'd like to touch briefly on the announcement we made earlier this week regarding the likely closure of SemiSouth Laboratories. As you may recall, we announced a strategic relationship with SemiSouth in 2010, with an eye towards utilizing their silicon carbide power devices to address high-power applications.

While we are disappointed in the outcome of this partnership, our strategic direction remains unchanged, and we continue to invest in high-power switch and driver technologies that will enable us to expand our addressable market within the realm of high-voltage power conversion.

For example, our acquisition of CT-Concept, which closed in May, enables us to address applications from tens of kilowatts all the way up to 1 gigawatt, including industrial motor drives, renewable energy systems, electric locomotives and automobiles and high voltage DC transmission systems.

Concept adds \$0.5 billion to our addressable market bringing our total market opportunity to \$2.5 billion and growing. Design activity is robust, in spite of the current economic climate and Concept won several high value designs in the third quarter, including a high voltage DC transmission system in the U.K., an electric locomotive program for the China market and a wind power inverter at major German industrial customer.

This acquisition has been accretive to non-GAAP earnings from day one and we believe we are well on our way to achieving the strategic and financial benefits we anticipated from the transaction.

Returning to the Q3 results, it's clear by now that the semiconductor industry is in the midst of a downturn due to global economic conditions. While third quarter sales were well within our projected range, order activity was relatively subdued throughout the quarter. Total bookings were roughly flat compared to the prior quarter and we have not seen a meaningful uptick thus far in October.

Based on this sub-seasonal pattern, we expect that revenues will decline sequentially in the fourth quarter to a range of \$71 to \$77 million, which would be down roughly 5% at the mid point.

While macroeconomic factors are a headwind for the time being, we believe we are well positioned to grow our topline once demands begins to recover. Design activity remains healthy despite the soft market conditions. We are seeing a strong early response to our new products, such as our fourth generation TinySwitch, as well as LinkSwitch-HP, which extends our primary site control capability to applications as high as 90 watts.

LED lighting remains the promising opportunity where we believe we have established a market leadership position, thanks to our unique combination of efficiency, reliability and low cost.

Revenues from LED applications grew roughly 20% sequentially in Q3 and accounted for the bulk of the organic growth in our industrial end market category. We also won more than 100 new LED designs in the quarter in a wide range of applications including replacement bulbs, down lights, tubes, signage and street lighting.

We also remain on track to roughly double our annual revenues from the mid power, that is, 50 to 500 watt market, another of our key growth vectors.

Our Hiper product line, which includes both power conversion and power factor correction chips, continues to ramp into the PC and TV markets, while complementary products like our Qspeed diodes and power saving CapZero ICs are increasing our dollar content in applications like PCs, appliances and telecom as customers look for cost effective ways to trim power consumption in order to keep pace with the tightening standards for standby power usage.

Gross margins continue to be a highlight of our results. Increasing for the fourth consecutive quarter and coming in higher than our projected range. As we have discussed on previous calls, the rise in our gross margin over the past year has been driven by two primary factors. One has been strong execution on a range of initiatives to bring down unit costs. The other is the shift in our end-market mix toward the higher margin industrial and consumer markets driven partly by Concept whose sales are included in our industrial end-market category and which has been meaningfully accretive to our gross margin.

Including Concept, two-thirds of our revenues now come from industrial and consumer applications. Naturally mix will fluctuate somewhat from quarter to quarter and we continue to expect a slightly less favorable mix in coming quarters as we ramp new business in lower margin markets like mobile phone chargers. However, we believe there has been a structural, sustainable shift in our business, which combined with our reduced manufacturing costs, should allow us to maintain a non-GAAP gross margin above the 50% level for the foreseeable future.

With that, I'll turn the call over Sandeep for a review of the financials.

Sandeep Nayar, Chief Financial Officer & Vice President

Thanks, Balu and good afternoon. I will begin with the charge related to SemiSouth which totaled \$59.2 million pre-tax. Of that amount, \$25.3 million appears as an operating expense on our income statement while the remaining \$33.9 million is shown below the line as an other expense item. Those amounts and the related tax benefits are excluded from our calculations of non-GAAP operating expenses and non-GAAP income as shown on the reconciliation tables in our press release. The expected cash [out]flow included in the charge is \$15.3 million.

Revenue for the quarter was \$78 million, a sequential increase of 2% and up 4% from a year ago. In terms of end-markets, industrial led the way with sequential growth of better than 10% aided by one additional month of revenues from the Concept acquisition which contributed only two months of revenues in the prior quarter. Excluding Concept, industrial revenues grew mid single-digits driven mainly by LED lighting applications. Revenues from the consumer end market increased slightly from the prior quarter driven by continued growth in the appliance market. Communications revenues were down slightly while computer revenues declined by a little more than 10%, reflecting the overall weakness in that end market.

Looking at the sales channels, distributors accounted for 76% of sales during the quarter with direct sales at 24%.

Gross margin on a non-GAAP basis was 52.9%, up 100 basis points sequentially and 570 basis points year-over-year.

As Balu indicated, the relative strength of industrial and consumer applications in recent quarters as well as the Concept acquisition has resulted in a more favorable end market mix providing significant margin uplift on top of the benefits of our cost reduction initiatives. Significantly, this margin improvement has come in spite of the continued strength of the Japanese yen versus the U.S. dollar, which has pressured our gross margin considerably over the past several years.

GAAP gross margin also came in higher than expected at 49.7%. The delta between GAAP and non-GAAP gross margin is driven largely by the write-off of the acquired Concept inventory, which should be just about fully amortized after the fourth quarter.

Non-GAAP operating expenses for the quarter were slightly below the midpoint of our range at \$25 million, up \$1.2 million sequentially driven primarily by the additional month of Concept plus the timing of our annual sales conference, which took place in September.

Non-GAAP operating margin picked up slightly to 20.9%. GAAP operating expenses totaled \$55 million for the quarter including the portion of SemiSouth categorized as an operating expense.

Our non-GAAP tax rate for the quarter was 12% reflecting the reduction we talked about last quarter in conjunction with the settlement of our tax audit. The settlement validated our international tax structure paving the way for a reduction in our tax rate for the balance of this year and then a further reduction next year as we discussed on last quarter's call.

Coming down to the bottom-line, we reported a net loss of \$1.54 per share on a GAAP basis driven by the SemiSouth charge. Non-GAAP earnings were \$0.49 per diluted share, flat sequentially and up more than 50% from a year ago.

Turning to the balance sheet, we ended the quarter with \$110 million in cash and investments, a decrease of \$23 million during the quarter, reflecting the payment of \$43 million in conjunction with our tax settlement which caused cash flow from operations to be negative for the quarter.

Reflecting the strength of our balance sheet, as well as the flexibility afforded to us by the repatriation rights that were part of our settlement with the I.R.S., our board of directors has authorized the use of up to \$50 million for share repurchases. As we have done with past buybacks, we intend to use a 10b5 plan with a predetermined price/volume matrix that regulates the level of buyback activity according to the stock price.

Internal inventories remain well under control, ticking down from the prior quarter both in terms of dollars and days. We ended the quarter with 109 days of inventory, down 6 days from the prior quarter and well within our targeted range.

Channel inventory also moved down slightly during the quarter ending at 5.4 weeks, compared to 5.5 weeks last quarter. And again, that's well within what we consider a reasonable range.

Turning to the outlook, as Balu mentioned, we expect revenues to be between \$71 million and \$77 million in the fourth quarter, and we expect gross margin to be similar to the third quarter levels.

Non-GAAP operating expenses should be flat to down slightly as we look to manage prudently through the current business environment. Specifically, we expect non-GAAP OpEx to be in the range of \$24.5 million to \$25 million, which excludes approximately \$4 million of stock-based compensation and \$1 million of amortization of acquisition related intangibles. The non-GAAP tax rate for the fourth quarter should be around 13% and then I expect it to move down into the high single digits beginning in Q1 of 2013.

With that, I'll turn it back over to Joe.

Joe Shiffler, Director-Investor Relations & Communications

Thanks, Sandeep. We'll open it up for Q&A now. I know there are some other calls going on in our peer group this afternoon, so in the interest of time, I'd like to ask everyone to stick to a limit of one question and one follow-up, and then we'll be happy to come around for a second round of questions, time permitting. Operator, would you please give the instructions for the Q&A.

QUESTION AND ANSWER SECTION

Operator: My pleasure, sir. [Operator Instructions] Our first question comes from Vernon Essi of Needham & Company. Your line is open.

<Q – Vernon Essi – Needham & Co. LLC>: I was wondering, if Balu, you could talk a little bit more about SemiSouth and just anything you'd be willing to provide us in terms of, I mean, you obviously seem like you understand the industry very well. Can you give us any understanding of what possibly happened here and how this came down so abruptly and ended so quickly?

<A – Balu Balakrishnan – Power Integrations, Inc.>: Well, I am kind of limited on what I can say, but what I would say is that the company was unable to meet key business milestones. And it's unfortunate that they are likely to close and we are taking this write off.

<Q – Vernon Essi – Needham & Co. LLC>: Okay. I mean, I guess, leading into that though, the milestones are obviously deteriorating. And it seemed as though things were getting more, the investment level from you was increasing. I'm just wondering what the thought process was behind the scenes on that?

<A – Balu Balakrishnan – Power Integrations, Inc.>: Well, when we made the last investment, it was very promising. They had orders from very large customers. And the reason we gave the money is working capital and expansion of capacity, and they were unable to deliver on that.

<Q – Vernon Essi – Needham & Co. LLC>: Okay. Thanks for that. And then my follow-on would be just on you made a mention of the phone charger market going forward. I'm wondering if you're investing more time and effort in that market versus maybe the last couple of quarters. Can you help us understand what you meant by that comment?

<A – Balu Balakrishnan – Power Integrations, Inc.>: Absolutely. Yes. As you know, three of our largest customers have had challenges over the last year and a half. So we've been focusing on other customers who have been very successful. And so far, we've been able to win about three larger Asian customers. In addition to that, we have won some smaller cell phone customers. I think we had a total of about a dozen design wins in the last quarter.

One of the three Asian customers that are already production, the other two will be ramping within the next two or three months. So, we expect to see an increase in share of business from new customers.

<Q – Vernon Essi – Needham & Co. LLC>: Okay. Great. Thank you.

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

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

<Q – Ross Seymore – Deutsche Bank Securities, Inc.>: Yeah. I've seen your downside guidance, not terribly surprising, given what we've heard from everybody else. Could you give us any color on what end markets are doing better or worse, just a little color by end market into that 5% please?

<A – Sandeep Nayyar – Power Integrations, Inc.>: It's very hard because our backlog you know, we really don't know where because of the same product for us goes into different applications. So it's very hard for us to tell where. But as you can see from the trend that we have had, we continue to do well in the industrial and the appliance market because of the diversity we had, things like

LED lighting, Concept and we are doing very well in major appliances. But obviously we do get impacted by the macroeconomic conditions and I think the guidance is reflective of that.

<A – Balu Balakrishnan – Power Integrations, Inc.>: Were you asking about the last quarter Ross?

<Q – Ross Seymore – Deutsche Bank Securities, Inc.>: No, going forward.

<A – Sandeep Nayyar – Power Integrations, Inc.>: Going forward, yes.

<A – Balu Balakrishnan – Power Integrations, Inc.>: Going forward is very difficult.

<Q – Ross Seymore – Deutsche Bank Securities, Inc.>: And I guess, as my follow up and I'll try to sneak in a two-parter. Do you expect the handset portion to go up, as you did expect before? And then the follow up, the true follow up would be in the gross margin side of things, is the yen impact at least stabilizing for you now, as you sell products that have been in inventory for a while? Or is it still an incremental headwind as we look forward?

<A – Balu Balakrishnan – Power Integrations, Inc.>: On the Yen, you're correct it has stabilized because it's been around JPY78 to JPY80 to \$1 for quite some time now. So it is pretty stable. As far as the cell phones, we should see an increase in share assuming everything else remains the same in the next year. Because of the new customers ramping production you will see a little bit of impact on Q4, but you will really see a bigger impact in the next year.

<Q – Ross Seymore – Deutsche Bank Securities, Inc.>: Great. Thank you.

<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.>: Hello, thank you. Maybe just kind of follow on that last question. Now that industrial is more than 30% of sales, I was wondering if you could give us some color on your outlook for this segment in Q4? Because it seems like a lot of your peers with heavy industrial exposure are guiding down pretty hard for Q4.

<A – Balu Balakrishnan – Power Integrations, Inc.>: So the Concept part of the business, we expect it to be relatively flat. It is actually positive because as you said most others are actually going down. So they are doing better than the rest of the market. And on our side, it is hard to predict. We did very well in Q3. So it's a little bit more difficult to predict because they have longer, what do you call, they get orders earlier than we do. And so it's a little bit more difficult to predict on our side, how well we'll do on the industrial segment. And the other thing I'd remember is that on our side of the, that is the non-Concept part of the industrial segment the growth has been mainly in the LED side, so when people talk about industrial, they are generally talking about large industrial and so the LED is one of the bright spots for us in the industrial area.

<Q – Andrew Huang – Sterne, Agee & Leach, Inc.>: Got it. Okay. Thank you and my follow on is can you remind us what leverage you have to improve gross margin going forward?

<A – Balu Balakrishnan – Power Integrations, Inc.>: I think most of the improvements are already in place. The only one that is still ongoing is the conversion from gold to copper that will go on for some more time. But it will be somewhat incremental and it will offset any price reductions we're expecting in the next few quarters, so it's not going to be a significant driver for the gross margin.

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

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

Operator: [Operator Instructions] Our next question comes from Sumit Dhanda of ISI Group. Your line is open.

<Q – Sumit Dhanda – International Strategy & Investment Group, Inc.>: First question, on the expectation for the fourth quarter you noted there wasn't really any pickup in October so far. I guess two questions related to that. First, could you describe the profile of bookings in September on a monthly basis? And then, what is the expectation through the end of the quarter? Is the expectation that bookings stay flat at current levels? They pick up a little bit? And how does that compare versus typical patterns? Thanks.

<A – Balu Balakrishnan – Power Integrations, Inc.>: In terms of last quarter, we saw some pick up in July after a very weak June. It went down a little bit in August, and since then it hasn't picked up in a noticeable fashion. Going forward, we obviously take a lot of things into consideration, not just the bookings. We look at the customers and so on and so forth. Obviously, that's included, all of those factors are included in our guidance. It's hard to predict exactly what the bookings would be, but from everything we can tell, our customers don't have much inventory. They seem to be ordering as they need products.

So my expectation is the bookings will reflect relatively closely what we ship, because that doesn't tell you what is going to be sold through. But since there is not much inventory, we expect most of it to sell through.

<Q – Sumit Dhanda – International Strategy & Investment Group, Inc.>: Okay. And then as my follow-up, you noted that ex-Concept industrial is up mid single digits mostly because of LED lighting. I remember earlier in the year you were, although you were optimistic on the LED lighting segment, your rhetoric was highlighting more competitive issues in the market. Has that waned a little bit? Or is the implication that despite the competitive issues this business is perhaps tracking a little better than you had thought? Any color around that would be great.

<A – Balu Balakrishnan – Power Integrations, Inc.>: Well, I think in the first half the problem was the market itself was weak and you are right, there are more competitors. But in spite of the competitors to the best we can calculate, we are at least holding our share which we believe is in the order of 20% or so. So we are doing quite well in LEDs. Obviously we are not going to grow as much as we thought originally because of the weakness of demand worldwide. But otherwise, we are doing quite well.

<Q – Sumit Dhanda – International Strategy & Investment Group, Inc.>: Okay. Thank you very much.

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

Operator: Thank you. Our next question comes from Steve Smigie of Raymond James. Your question please.

<Q – Steve Smigie – Raymond James & Associates>: Great. Thanks a lot. Balu, I was hoping you could talk a little bit about the handset charger strategy for you guys. I guess, on one hand you said you are trying to push into much higher power areas, I think presumably to be in a market that's less competitive, but at the same time you still seem to be chasing some design wins. And my thought was you were sort of de-emphasizing the charger handset business a little bit. I just hoping you could talk about that?

<A – Balu Balakrishnan – Power Integrations, Inc.>: I don't think we ever said we de-emphasized the charger business. All we said was, we have the luxury to pick the business we want to take and whenever we are able to convince the customer that the value we bring, you know, justifies the price, we take the business. If we are compared to alternatives that are not equivalent in terms of quality and reliability, we tend to walk away.

But we have no intention, we've never had the intention of leaving the cell phone business or any charger business for that matter.

<Q – Steve Smigie – Raymond James & Associates>: Okay. My final question is with regard to SemiSouth, I think one thing you had hoped to accomplish with CT-Concept was to work more closely with SemiSouth. Obviously, SemiSouth's having issues but, so what are the directions can you now take business that you were hoping to do with SemiSouth? Are there other silicon carbide products out there you can work with? Can you still develop silicon carbide technology? Can you help me understand a little bit better? That would be great.

<A – Balu Balakrishnan – Power Integrations, Inc.>: Okay. First of all, the CT-Concept business makes perfect sense independent of silicon carbide or any switching technology or SemiSouth. We acquired Concept because they had a very good business as they drive IGBT switches, the main switching technology today and it will be that way for some time to come.

And as far as our strategy that hasn't changed at all. We have basically given up on the SemiSouth silicon carbide technology. But we continue to invest in other switch technologies. And our intention is still to go to higher power levels where we would have both the switch technology and the driver technology. And the driver technology of course, comes from CT-Concept.

<Q – Steve Smigie – Raymond James & Associates>: Okay. Great. Thank you very much.

<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, guys. Can you remind us of what programs you currently have in place for desktop PCs for primary power supplies? And then what could be ramping ahead?

<A – Balu Balakrishnan – Power Integrations, Inc.>: And what do you mean by primary power supply, the main power supply there...?

<Q – Andrew Huang – Sterne, Agee & Leach, Inc.>: I'm sorry, the main primary supply, main power supply, yes.

<A – Balu Balakrishnan – Power Integrations, Inc.>: I got it. So currently we have three end OEMs, large OEMs. They are well recognized names. And we supply our products to three power supply companies who in turn sell to those OEMs. Some of them sell to more than one.

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

<A – Balu Balakrishnan – Power Integrations, Inc.>: And you know the third one was recently added by the way in Q3, the third OEM.

<Q – Andrew Huang – Sterne, Agee & Leach, Inc.>: Okay. But now if I look at like the number of, if I look at the power supplies that are being shifted into the desktop PC market, the mains, what

percentage of them do you think are using kind of switching technology, semiconductor technology as opposed to discrete technology? Do you have an idea of the penetration?

<A – Balu Balakrishnan – Power Integrations, Inc.>: As far as we know, all of the existing solutions are discrete. We are the only one to offer integrated solutions, highly integrated solutions to that market.

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

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

Operator: Thank you. As there are no further questions in queue at this time, I like to turn the call back over to Mr. Shiffler for any closing remarks.

Joe Shiffler, Director-Investor Relations & Communications

Okay, thanks. We'll leave it there. Thanks everyone for listening. There will be replay of this call available on our website, which is investors.powerint.com. Thanks again for listening and good afternoon.

Operator: Thank you, sir and thank you ladies and gentlemen for your participation. That does conclude your program. You may disconnect your lines at this time. Have a great day.

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